A WORLD BANK COUNTRY STUDY

Zambia

Public Expenditure Management and Financial Accountability Review

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The report benefited from active participation of Zambian Government officials and of donor representatives. A partial list of names appears below.

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Abbreviations and Acronyms

ABB	Activity Based Budgeting
ACC	Anti-Corruption Commission
AccG	Accountant General
AfDB	African Development Bank
AG	Auditor General
AO	Accounting Officer
BFP	Budget Framework Paper
BoZ	Bank of Zambia
CAB	Computer-Aided Budgeting
CAS	Country Assistance Strategy
CBH	Central Board of Health
CCS	Commitment Control System
CFAA	Country Financial Accountability Assessment
CMU	Commitment monitoring unit
CO	Controlling Officer
CPAR	Country Procurement Assessment Review
CTC	Central Tender Committee
DMFAS	Depth Management and Financial Analysis System
ESAC	Economic and Social Adjustment Credit (World Bank)
ESDS	Educational Services Delivery Survey
ESW	Economic and Sector Work
EU	European Union
FAR	Financial Accountability Report
FMS	Financial Management System
FMU	Financial Management Unit
FSC	Fiscal Sustainability Credit
FY	Fiscal Year
GDP	Gross Domestic product
GFS	Government Financial Statistics
GRZ	Government of the Republic of Zambia
HIPC	Heavily Indebted Poor Countries
HIV/AIDS	Human Immunodeficiency Virus/ Acquired Immunodeficiency Syndrome
IA	Internal Audit
IFAC-PSC	Public Sector Committee of the International Federation of Accountants
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
KCM	Konkola Copper Mines
KDMP	Konkola Deep Mining Project
LCC	Local Cost Compensation

LCMS	Living Conditions Monitoring Survey
LM	Line Ministry
LPO	Local Purchase order
MFNP	Ministry of Finance and National Planning LPO
MoH	Ministry of Health
MTBPS	Medium Term Budget Policy Statement
MTEF	Medium Term Expenditure Framework
MTPRS	Medium Term Pay Reform Strategy
MWS	Ministry of Works and Supply
OAG	Office of the Auditor General
OP	Operational Policy
PAC	Policy Analysis and Co-ordination (Division of Cabinet Office)
PE	Personal Emoluments
PEM	Public Expenditure Management
PEMFA	Public Expenditure Management and Financial Accountability
PETS	Public Expenditure Tracking Surveys
PPP	Purchasing Power Parity
PRGF	Poverty Reduction and Growth Facility
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PS	Permanent Secretary
PSC	Public Service Commission
PSCAP	Public Service Capacity Building Project
PSMD	Public Service Management Division
PSPF	Public Service Pensions Fund
PSRP	Public Sector Reform Program
PSU	Procurement Supply Units
PTA	Parent Teachers Association
RDC	Recurrent Department Charges
RFP	Request for Proposals
SASE	Selective Accelerated Salary Enhancement
SOE	State Owned Enterprise
SSA	Sub-Saharan Africa
ST	Secretary to the Treasury
TA	Technical Assistant
TAZAMA	Tanzania/Zambia Pipeline
TAZARA	Tanzania–Zambia Railways
TNDP	Transitional National Development Plan
UNCITRAL	United Nations Commission International Trade Laws
US$	U.S. Dollars
VAT	Value-added Tax
WSM	Works and Supply Ministry
WHO	World Health Organization
ZAMIM	Zambia Institute of Management
ZBIC	Zambia Insurance Business College Trust
ZCCM	Zambia Consolidated Copper Mines

ZESCO	Zambia Electricity Supply Company
ZNOC	Zambia National Oil Company
ZNTB	Zambia National Tender Board
ZNTBA	Zambia National Tender Board Act
ZR	Zambia Railways

Fiscal Year Of Budget

January 1–December 31
Currency Equivalents
currency unit: Zambian Kwacha (K)
US$ = 4785 Kwacha (Exchange rate Effective as of June 10, 2003)

Weights and Measures

Metric System

Executive Summary

Zambia's economy is not growing fast. Poverty is on the rise. The quality of economic governance is on the decline. And public resources are not well spent.

The badly-needed first steps to reverse all this are: getting the budgetary allocations right and making sure those allocations go to where they're supposed to go. That requires making the public aware of the government's budgetary decisions and holding the government accountable for better performance. Only through broader disclosure of the government's resources and liabilities will it be possible for Zambians to develop workable strategies to tackle the many economic challenges that lie ahead.

Budgets, now noncredible, have to become credible. Spending rules, where they exist, have to be strengthened and enforced. Where rules are missing, they have to be created and once again enforced—to remove today's pernicious discretion.

Addressing the longstanding challenges that Zambia faces in public expenditure management will require targeted efforts and strong political will. The new constitutional review of public finance, the anticorruption campaign of the new government, and the new interest of parliament in governance and accountability are all encouraging.

Yet, for Zambia to assure that public accountability is enduring and not dependent on the government of the day, it must strengthen institutions that can provide public oversight and promote basic checks and balances. Despite a legal framework based on the Westminster tradition of government, many of Zambia's public finance laws and regulations are not enforced. So, the administrative systems and procedures to control expenditures have broken down.

Audit systems to detect improprieties are ineffective because the Auditor General's recommendations are not enforced. This lack of sanctions only emboldens those engaging in improper activities. The lack of transparency in budget management—caused in part by weak financial reporting—means the public cannot understand the economic tradeoffs required of Zambia today.

The limited capacity of government suggests targeting a few major aspects of public finance:

- Improving compliance with existing regulations.
- Strengthening the state's oversight institutions.
- Promoting public access to information.
- Rebuilding information management and reporting systems.

Strengthening the Laws and Institutions for Accountability

In a system with democratic control of public expenditure, the parliament typically approves the budget presented by the executive as well as any major changes needed during the budget year. However, under the current financial provisions in Zambia's Constitution, the Ministry of Finance can make sweeping changes in the budget allocations without prior consent of Parliament—flexibility that could easily be misused without proper parliamentary oversight.

Even where the legal provisions are appropriate, they hinge on a system of *enforcement and accountability* that does not work. The current public finance rules are based on an assumption that Ministry of Finance plays a primary role of stewardship or guardianship over the public purse and that it enforces an adherence to the rules by line ministries. Yet, the Ministry has not held controlling officers accountable for their management of public resources. Nor has the parliament been in a position to hold the Executive accountable. Without these checks and balances, the system simply breaks down.

Getting Budgetary Allocations Right

Zambia must first improve the credibility of the budget. Ineffective and unrealistic budget preparation has followup implications for budget execution, procurement, and ultimately for service delivery. For years now, budgets have committed more than is available. The most obvious result is that actual spending at the end of the year bears little relationship to the original estimates. Consequently, most line ministries realize that the budget is not a reliable basis for planning since releases are unpredictable, varying substantially from the amounts in the budget.

Government budgets largely reflected only incremental changes from the prior year, without tackling the policy decisions needed to bring costs in line with resources. Even when the budget appears to be in balance on an aggregate basis—with enough revenues and financing to cover expenses—budgets for some ministry activities are insufficient to cover the actual costs.

Some activities have fixed costs that must be met, whether or not the activities are fully funded in the budget document. Ultimately, these activities receive a supplemental budget, squeezing out funding for other activities previously budgeted. Going forward, Zambia should:

- Reconcile the large differences between historical cost and proposed budget estimates.
- Strictly limit the use of supplementary appropriations.

Zambia's budget preparation also requires substantial improvement in comprehensiveness, classification, the presentation of the budget document, the links between budgeting, policy, and planning, and the timing of the budget cycle.

- *Comprehensiveness.* Zambia's budget is confined to central government and lacks information on state enterprises, pension funds, special funds, quasi-governmental activities, and local government expenditures. This presents a misleading picture of the financial position of the State, especially due to the heavy losses and contingent liabilities coming from state enterprises and public sector pension funds.
- *Classification.* Lacking any functional or programmatic classification, it is difficult to identify poverty-reducing expenditures in the budget, except in very broad terms. In addition, the economic classification often hides the true nature of expenditures, with personnel-related costs spread across several categories. The government's promising attempts to pilot Activity Based Budgeting have borne limited fruit to date.

- *Budget presentation.* The poor format and quality of the government's budget document has a direct bearing on parliament's ability to provide effective oversight—and for other stakeholders to understand the budget. An immediate objective should be to include expenditure data from the prior year, alongside an estimate of the current year to enable comparison the proposed budget estimates. Also needed: information on the status of capital projects, more summary tables, and more explanation of the major changes in the budget and the reasons for them.
- *Links between policy, planning, and budgeting.* Poor communication from donors on possible resource inflows compounds the government's budget and policy planning. The problems of credibility and structural overcommitment of the budget underline the importance of integrating some type of medium-term planning horizon and decisionmaking into the annual budget process. The government should ensure that new government activities are not initiated without a realistic and comprehensive multiyear costing, and more important, without an explicit indication from where the additional resources or offsetting savings would come. While a fully functioning Medium-Term Expenditure Framework may be a longer term objective in Zambia, the commencement of an MTEF process for 2004–2006 is an encouraging step which must be sustained and strengthened.

Making Sure Funds Go Where They Should

Improvements in budget execution must abolish cash rationing, enforce expenditure controls, properly record commitments, especially for capital projects, update payroll lists systematically, and reform procurement practices and regulations.

- *Abolishing cash rationing.* Although an understandable response to macroeconomic crisis at the time of its creation in 1993, the cash budgeting process has persisted until today in ways that are highly destabilizing to effective public expenditure management.

  One of the major consequences is that actual expenditures by line ministries bear little relationship to the budget approved by Parliament. Because of the unpredictable nature of the cash releases from month to month, line ministries have had few means for planning basic operational and management needs. This has an inevitable impact on procurement practices and encourages an accumulation of supplier credits and higher prices charged to government.
- *Enforcing financial regulations.* Many spending departments in Zambia operate as if standing instructions on the cash control mechanism do not exist. Orders are placed and payment vouchers are prepared and kept (often unrecorded) until cash is available. In some cases, checks are issued before the delivery of goods, and presented to the procurement staff (or stores) for exchange against goods.

  Spending agencies use overdrafts to pay for expenditures over and above the budget. Control mechanisms are largely designed for a manual system based on segregation of duty and discipline to apply the rules. Yet, changes, especially the greater volume of transactions, have made the controls ineffective. Although manuals and guidelines exist, staff are not well trained. Nor do they have copies for reference.

- *Controlling commitments.* A chronic buildup of arrears undermines the integrity and value of the annual budget. Even though financial regulations prohibit line ministries from committing more than they have resources to pay, they continue to do so. Quarterly commitment reports prepared by the Accountant General are supposed to be used to identify overcommitting ministries, but sanctions are rarely forthcoming. The worst problems with arrears are for capital projects.
- *Controlling payrolls.* The high share of payrolls in the budget and the lack of effective controls for updating the payroll list are a significant financial risk. In 2001, 37.5 percent of budget releases were for personal emoluments. Some losses come from the use of cash payments in districts outside the banking network.

  Of greater concern are the weak procedures for managing and controlling the payroll database. One of the ways "ghosts" may be introduced is through inefficient recording of personnel separations so that payments continue long after a person has ended service with the government. Today, the payroll management system may be described as passive, in that the management system awaits notification in the case of employee separation or transfer. Reports that can be generated on who has been paid each month do not reach those who can exercise control.
- *Stopping arrears for capital projects.* These have been amongst the most pervasive and costly, and will require a much deeper linkage between commitment monitoring and cash management. Although only a small part of the total budget, losses on domestically financed capital projects can be quite significant. Some estimate that capital projects in Zambia may cost twice as much as they should. Two main problems: budget releases for the Ministry of Works and Supply are insufficient to cover the obligations the government has incurred, and a lack of comprehensive and transparent accounting inhibits setting priorities for cash needs. In addition, the structure of the contracts, if not managed aggressively, can allow the overall costs to skyrocket.
- *Improving public procurement.* The total value of public procurement in 2001 was estimated at $485 million, 15 percent of Zambia's GDP. Even a conservative saving of 10 percent through better procurement policies, practices, and institutional arrangements would save the Treasury $50 million yearly. That makes the development of a well-functioning procurement system essential, based on transparency, competition, economy and efficiency, fairness, and accountability. Activities of the Anti-Corruption Commission and the Office of the Auditor General are critical in this.

Several factors now limit effective public procurement. First, a gap between intentions and practice pervades various aspects of public procurement. Weaknesses in the structure and content of the legal and institutional framework allow undesirable practices and procedures. The Zambia National Tender Board is expected to enforce procurement rules, but it is liberal in permitting exceptions and allowing negotiations to replace clear procurement guidelines. Current practices that foster corruption and higher prices include using negotiations as an accepted procurement method and misusing the registration system for purchases from short-listed firms.

Second, the legal framework lacks robustness and features structural, and content, inadequacies. Aspects that should be in the Zambia National Tender Board Act are in the regulations or guidelines and vice versa.

Third, procurement management is weak. In the few departments where they do exist, procurement files are often incomplete, and procurement planning is largely nonexistent as a tool for conducting efficient and economic procurement.

Fourth, there has been no progress in setting up a procurement cadre, despite the fact that more than 600 people have been trained at different levels.

Tracking Spending

The current systems for financial management are either manual or rely on outdated technology with limited applications. Budget preparation, budget execution, and payroll management are all separate. Independent applications in the Finance Ministry do not interact with each other. The few personal computers available in the Ministry are outdated. In line ministries, the situation is generally worse, with reliance upon basic spreadsheet applications where available. The accounting function relies heavily on manual recordkeeping, especially in the line ministries. Line ministries and provinces submit their monthly expenditures reports on diskette to the Ministry with the help of a computer-based Financial Management System, which records the details of transactions after payments are made.

The problems:

- Expenditure reports are prone to errors, and inconsistencies are difficult to find and reconcile.
- Reporting tends to be significantly delayed because of the various levels of compilation required.
- The focus on bookkeeping tasks distracts accounting staff from more meaningful analysis of the data and trends.
- The delays and inconsistencies greatly diminish the ability of the Ministry of Finance to provide enough oversight and control over the nature of expenditures.

Because of these inadequacies, the Ministry has found it difficult to provide an accurate, complete, and transparent account of its financial position to Parliament and other stakeholders, including the general public and donors.

Compounding these matters, shortcuts and deviations from accounting and reporting regulations have developed that harm the accuracy and reliability of ledgers for recording commitments. The shortcuts may originate from the shortages in staffing, the absence of training, the reorganization of offices, and the increase in the sheer volume of (largely manual) transactions. The quality of monthly outturn reporting by line ministries remains uneven, though it has improved somewhat. The audited Financial Report for FY2000 was the first delivered to Parliament on time in about a decade, but significant problems could affect the quality of the information in the Financial Report. Key information appears to be missing from bank reconciliation statements. Ledgers are improperly kept. Internal control mechanisms are sometimes missing from reorganized agencies. Quarterly consolidated reports are subject to double counting. And the role of the Accountant General is not adequately defined.

Box 1. Reforming Pay

Even with excellent policies and procedures, sound financial management will be difficult to achieve without properly motivated and skilled staff. Yet, low pay hurts recruitment, retention, motivation, and productivity. Added to this is a poorly constructed internal grading structure and an increments system based on length of service not performance. Both stifle initiative. The fragmentation of job grades and the dependence on allowances to enhance compensation have severely weakened horizontal and vertical equity. Fringe benefit and monetary allowances have increased compensation, particularly for upper-level and senior civil servants.

The wage bill has remained large relative to overall government recurrent expenditures, crowding out operational expenditures. The challenge is to design and implement a pay reform strategy containing the wage bill (as a proportion of GDP).

The characteristics of such a pay reform strategy would include:

- Being consistent with an affordable resource envelope.
- Controlling the size and growth of government employment.
- Eliminating the distortions and anomalies, and paying salaries commensurate with skills, experience, and responsibilities.
- Progressively consolidating all allowances into basic pay.
- Progressively decompressing the pay of senior and middle ranking staff.
- Designing and implementing a new performance management system and employment policy.

Short-term measures will include completing the payroll data cleaning and retrenchment packages to offset the cost of the 2003 salary increases. Medium-term actions include restructuring and rightsizing the public sector to control the size of the wage bill, and its structure and composition. This will need to be complemented by further decompression and consolidation of allowances within the feasible budget envelope to attract and keep skilled and qualified personnel.

Unless actions are taken to punish corrupt behavior, pay increases alone are unlikely to end corrupt practices in the public sector.

An Integrated Financial Management Information System, though not a panacea, could improve reliability and timeliness of financial data, strengthen financial controls, extend data comprehensiveness, and generally enhance transparency of budget execution. Development of such a system has been progressing steadily, but it is only a tool. It is no substitute for implementing the basic measures needed to improve budget accounting and financial reporting. Indeed, the system should be pursued only as a complement to, and in parallel with, such basic measures.

The Internal Audit department of the Ministry of Finance has a critical role in maintaining the pre-audit controls on expenditure—and in assessing the overall adequacy of the financial management systems and procedures in place. The Internal Auditors have been effective in diagnosing problems in the financial management procedures. However, their impact is still severely limited by the lack of adequate human and financial resources to carry out their work. Furthermore, follow-up on their recommendations by Controlling Officers is insufficient.

Outside auditing has benefited from various training opportunities in recent years, but it remains weak in many respects. The Auditor General enjoys a constitutional backing and independence, but in practice his independence is hampered by limitations in financing imposed by the Ministry of Finance and staffing imposed by civil service regulations. Audit planning and methods are, in principle, recommended by the International Organization of Supreme Audit Institutions, but compliance is low. The audits consist mainly of financial and regularity audit, which are often limited in scope, and audit reports are inconclusive and untimely. The Office of the Auditor General operates with severe staffing problems, with only one professionally qualified auditor.

Box 2. Funds Aren't Reaching Schools

The flow of public funding to schools in Zambia is organized through a three-tiered administrative hierarchy involving provincial offices, district offices, and schools. Funds can be classified as rule-based allocations to schools, discretionary allocations to schools, rule-based allocations to teachers, and discretionary allocations to teachers.

A tracking exercise for all *nonsalary funding flows* through the administrative hierarchy found that on average about K28,000 per pupil enters the educational system for the Eastern, Northern, Lusaka, and Copperbelt provinces, with significant variation. Of this amount, discretionary funds account for 70 percent of all provincial and district funding, rule-based funds for the remaining 30 percent.

- Only one-sixth to one-third of total funding in the system eventually reaches schools. Of this total amount, between 14 percent (Lusaka) and 34 percent (Copperbelt) eventually reaches the schools as a combination of rule-based and discretionary spending. The rest is spent at the provincial and district levels.
- "Decentralization" has shifted spending from the provincial to the district level, but has not resulted in greater disbursements to schools. The extra funding that reaches the districts in decentralized provinces just results in higher spending at the district level and is not associated with greater funding to schools.
- The specific rule used in rule-based allocations (a fixed amount per school) has led to greater funding per pupil for poorer and more rural schools. Yet, these allocations are the *only* progressive disbursements. Once all sources of public funding are factored in, public school funding in Zambia is regressive, with allocations to richer schools almost 30 percent higher.

What Now?

For public expenditures to have any significant impact on poverty, Zambia must significantly improve its public expenditure management and financial accountability. It met only 3 of 15 public expenditure management benchmarks in an expenditure tracking review for the Highly Indebted Poor Countries Initiative in 2002.

The most important actions are not the technical ones, but those requiring policy decisions:

- *Revise the legal framework for financial management.* Supplemental appropriations should be permitted legally only with the prior approval of Parliament. Emergency expenditures and excess expenditures should also be much more strictly limited. The financial statements of the government should be submitted to Parliament within six months of the end of the fiscal year.

- *Strengthen Parliament's oversight over the budget.* Submit the macroeconomic framework and functional priorities to Parliament earlier in the budget calendar, submit regular reports on budget execution for information (semi-annually), and ensure appropriate followup on the Auditor General's reports.
- *Improve the presentation of the budget.* Present to Parliament a budget that clearly compares the proposed budget with the actual expenditures from the preceding two years. This should facilitate an informed debate on the realism of the budget and the government's policy priorities.
- *Strictly limit the use of supplemental appropriations.* Prevent ministries from relying upon supplemental appropriations, perhaps limiting total supplemental spending to about 5–10 percent of the budget.
- *Establish quarterly expenditure ceilings for line ministries, back ceilings with actual cash releases, and sanction controlling officers who overcommit.* The Ministry of Finance must first develop and enforce credible expenditure ceilings. Controlling officers who persistently overcommit should be sanctioned.
- *Ensure the independence of the Office of the Auditor General by creating an Audit Board (oversight body) that reports to Parliament.* The Auditor General's budget and staffing should be determined by the Audit Board not by the Executive.

These measures are the foundation of a larger reform agenda. This reform agenda cannot, however, be sustained without a strong political leadership and commitment to follow-through on agreed reforms and processes. *It requires a clear break from the past in terms of government behavior.* The commitment of the cabinet to the agreed budget, and the active participation of the political leadership in monitoring the implementation of the budget are essential. The Parliament should be involved in the preparation of the budget (or MTEF) as well as in providing an oversight over spending. There must be a transparent process for granting supplementary estimates. The Government should promote transparency and improve its reporting on public resource uses to all stakeholders (through implementation of IFMIS). Moreover, there must be the political will to enforce Zambia's rules and regulations for public spending, and sanction erring officers. With such a strong political commitment, the Government can address many of the key public finance and accountability problems immediately, as these reforms generally require only a policy decision for implementation (rather than extensive technical assistance). On the other hand, without the above fundamental policy measures, it will be difficult for the Government to improve its delivery of public services to the poor.

PART I

Introduction and Context

CHAPTER 1

Introduction

Over the last few years, Zambia has undertaken a number of fiscal reforms aimed at improving public expenditure and financial management. The international community, including the World Bank, IMF, AfDB, EU, and bilateral donors, has supported these reforms. While sizable progress has been made recently, considerable weaknesses remain in the areas of budget management, financial reporting and audit, public procurement, and financial accountability.

The World Bank's Public Service Capacity Building Project (PSCAP) and Fiscal Sustainability Credit 1 (FSC1) were among the key instruments focused on helping the Government of Zambia in improving public expenditure management and financial accountability over the last few years.

PSCAP became effective in October 2000. The project's objective is to make public service delivery processes more effective and efficient in order to facilitate growth and poverty reduction. During its Phase I implementation (October 2000–June 2002), PSCAP helped achieve numerous positive developments in terms of improving service delivery. Considerable training and capacity building as well as significant purchases of computers, vehicles, and office equipment took place under the assistance of the Project. However, more needs to be done on some key policy reforms such as right-sizing the public sector, procurement, decentralization, and ensuring the independence of the Auditor General.

One key component of PSCAP was to improve financial management, accountability, and transparency by helping the Government to implement MTEF and IFMIS, training the Auditor General's staff, increasing the frequency and regularity of audit reports, improving the quality and timeliness of Office of Auditor General (OAG) reports, and training the Zambia National Tender Board's (ZNTB) staff as well as other procurement support units at line ministries. Some progress was achieved with respect to many of these planned interventions. For example, the Office of the Auditor General undertook site visits for activities that had not been audited for many years; the Zambia National Tender Board enhanced its inspection and oversight function; computers and other equipment allowed the Office of the Auditor General to improve the quality and timeliness of reports; the Ministry of Finance and National Planning (MFNP) implemented improvements to Financial Management System (FMS) utilizing PSCAP financed equipment; computers were provided for urgent commitment control needs in the Treasury; and, action plans have been developed for implementation of IFMIS and MTEF.[1] Yet, what has been achieved so far is just the beginning of a long process of reform that will be required to bring about system-wide gains and improvements in effectiveness and efficiency of public expenditures in Zambia. This process needs to be sustained and intensified in the future.

Fiscal Sustainability Credit 1 (FSC1) became effective in August 2000. Public expenditure reforms under FSC1 aimed at introducing spending rules that would help achieve greater predictability, accountability, and transparency at the Central Government level. In terms of ensuring greater predictability, FSC1 sought to protect the share of expenditure allocated to line Ministries in the budget by requiring the MFNP to allocate to these Ministries at least 80 percent of what they are entitled to receive from the voted budget. In terms of accountability, FSC1 primarily helped the Government introduce measures to strengthen control over commitments of line Ministries to suppliers when no resources have been approved for such spending. This measure is related to the predictability measure in that lack of commitment control is to some extent a consequence of the unpredictability of cash flow, and predictability would help reduce commitments for which there is no budget approval. In terms of transparency, a measure was introduced to publish a monthly report on Government expenditures. In general, while these measures have incrementally helped Zambia move towards better budget management, their overall impact was very limited.[2]

Clearly, a longer and sustained reform is needed to reverse institutional and behavioral problems that have accumulated over the past several years in Zambia. Looking ahead, much remains to be done in terms of improving fiscal management and judicious use of the limited resources in order to further reduce the public sector deficit, improve government transparency and accountability, and increase the impact of public services on growth and poverty reduction. Institutional and complementary reforms need to move ahead to ensure the effectiveness and efficiency of public resources and HIPC debt relief, provide adequate public infrastructure and social services, and help in the diversification of the economy away from copper.

From the Bank's point of view, issues related to public expenditure management and financial accountability will form the core of the Bank's country assistance strategy (CAS) and dialogue for a number of reasons. First, the PRSP emphasizes the need to monitor poverty and to improve public expenditure effectiveness and service delivery as key components of poverty reduction in Zambia. Second, the Bank's future support of

1. For more details on PSCAP, see World Bank Aide Memoire: Zambia Public Sector Capacity Building Project (PSCAP) Mid-term Review; October 14–25, 2002.

2. For more details on FSC 1, see the credit's Implementation Completion Report; December 28, 2002.

the PRSP will be based on the Government's ability to implement poverty reducing programs in an efficient, equitable, and transparent manner. In turn, this ability depends on, among other factors, the quality and quantity of spending for the poor. Third, donors are increasingly focusing on public sector accountability as a key indicator for aid effectiveness and, in the context of HIPC debt relief, they have placed these issues at the top of their country assistance strategies. Recognizing these factors, the Bank's Interim Guidelines for preparation of PRSCs call for an ex-ante assessment of a country's public financial accountability, including an assessment of public expenditure, procurement, and financial management systems before the development of a CAS and/or PRSC program in the country.[3]

In terms of diagnostic work (Economic and Sector Work), over the last few years the Bank has prepared two major reports on public expenditure management in Zambia, which have addressed different but overlapping dimensions of public expenditure management. The 1998 Fiscal Management Report focused on fiscal sustainability issues, and underscored the importance of reducing quasi-fiscal deficits—deficits of parastatals, Bank of Zambia, pension funds, extra-budgetary funds—in achieving full sustainable fiscal position and full macroeconomic stability. The 2001 Public Expenditure Review focused on budget allocation and execution problems in Zambia, and provided sector-specific recommendations for better public expenditure management and effectiveness. This current report is the third major analytical report in this field.

This report builds on the existing Bank ESW and IMF diagnostics to provide a comprehensive and integrated assessment of Zambia's overall fiduciary risk, as seen in the areas of budget management, financial systems and auditing, and public procurement. It provides not only an assessment of current practices and institutional arrangements, but also a guide to the substantive progress made in recent years and the key priorities for the Government to focus on in the years ahead. The report is intended to provide both donors and the Government of the Republic of Zambia (GRZ) with a candid review of public sector problems and a roadmap of short and medium term actions in which donors can provide assistance.[4] Such an action plan will take into consideration the limited financial and human resource capacity of the Government and the importance of closer donor collaboration. This report, in conjunction with the previous two other reports, is hoped to provide a solid analytical basis from which the Bank can engage the Government in the area of public expenditure management and accountability over the coming years.

The rest of the report is organized as follows. Chapter 2 will assess Zambia's past performance in terms of the macro-economy and poverty reduction. It will then focus on two key areas for refocusing public expenditure towards poverty reduction—reducing the fiscal drain of parastatals and improving the efficiency and effectiveness of existing public expenditure. Chapter 3 gives an overview of the trends in governance in Zambia, the governance and accountability framework, the constitutional provisions for financial accountability, and the role of parliamentary oversight for public expendi-

3. See OP 8.6, Memo from Ms. Salop to Staff Recipients of the Operational Manual on Interim Guidelines for Poverty Reduction Support Credits, dated May 31, 2001, Attachment I.

4. In addition to the main report, the Country Financial Accountability Assessment (CFAA) and the Country Procurement Assessment Review (CPAR) constitute annexes to the main report.

ture management and financial accountability. Chapter 4 explores budget preparation issues, including the budget's credibility, comprehensiveness, classification, and presentation to Parliament as well as the development of a medium term expenditure framework (MTEF). Chapter 5 focuses on analysis of budget execution and expenditure control issues. It covers expenditure control, commitment control and arrears management, payroll controls, capital expenditure controls and asset management, and public procurement. Chapter 6 deals with accounting, financial reporting, and budget audit. It covers a description of the current accounting and reporting systems, the role of IFMIS as a medium- to long-term tool for improving financial management, accountability, and reporting, and the role and status of internal and external audits in Zambia. Chapter 7 focuses on human resources and pay reform issues as they relate to capacity enhancement for effective implementation of public sector reforms in general and effective budget management in particular. Chapter 8 uses the Education sector as a case study to examine the actual flow of funds through the administrative network, and assesses leakages and inequity in distribution of public resources in the education sector. Chapter 9 discusses the public expenditure and financial accountability vision that the Government aspires to in the medium term and, in that context, a program of priority actions that would enhance Zambia's accountability, transparency, and predictability in public spending.

This report has three main annexes. Annex I, which is provided at the end of the report, covers a number of key issues corresponding to the chapters of the report. Annex II is the Country Financial Accountability Assessment (CFAA), which provides detailed assessment of financial accountability issues. Annex III is the Country Procurement Assessment Review (CPAR), which covers public procurement issues in detail. The CFAA and CPAR annexes are issued separately and are available upon request from the authors.

CHAPTER 2

The Macroeconomic Context for Public Expenditure Reform in Zambia

In this chapter, we will address three main issues. First, we will review the progress in macroeconomic and poverty indicators in Zambia, particularly during the 1990s. This section shows that while Zambia's macroeconomic stability has gradually improved, full macroeconomic stability is yet to be achieved. Furthermore, the country saw an increase in poverty and a deterioration in the key social indicators in the 1990s. Second, we will highlight the connection between public expenditure, macroeconomic performance, and improvements in social indicators and poverty. Although Zambia has made considerable efforts since the mid-1990s in increasing and subsequently maintaining the nominal expenditure shares on social sector, expenditures in real terms have fallen. While the decline in real expenditures was underpinned by lack of growth and high inflation, the deterioration in the social indicators was because of low real spending, poor public expenditure management and financial accountability, low public sector efficiency and poor quality of services, and the HIV/AIDS pandemic. Third, the scope for increasing domestic revenue through taxation is limited in the short term. Given this limited scope, the GRZ would need to focus on maximizing the impact on poverty of existing public expenditures. In this respect, reducing the fiscal drain of parastatals, and promoting effective and transparent utilization of existing resources through better public expenditure management, financial accountability, and procurement systems is critical.

Progress in Macroeconomic and Poverty Indicators

Progress in Macroeconomic Performance

With an estimated per capita income in 2002 of about US$320, Zambia is one of the poorest countries in sub-Saharan Africa. Zambia's economy exhibits heavy dependence on mineral resources and exports, in particular copper, which generates over 50 percent of the foreign exchange earnings of the country. Over the last three decades (first three columns of Table 1), the structure of the economy and composition of output changed perceptibly: the share of agriculture in the economy increased from around 15 percent in the 1970s to about 21 percent in the 1990s; manufacturing from 16 percent to 21 percent; services from 35 percent to 40 percent; and energy from 2.4 percent to 2.8 percent. On the other hand, the share of mining declined from 24 percent to about 11 percent and that of construction from 7.3 percent to about 4.5 percent. As of 2000, nearly half of the Gross Domestic Product (GDP) came from services, about 27 percent from agriculture, and about 13 percent from manufacturing. Mining contributed only about 3 percent of GDP (last column of Table 1).

Table 1. Zambia: Structure of Output and Real GDP Growth, 1970s–2000 (in percent)

	1970s Avg.	1980s Avg.	1990s Avg.	YR95	YR96	YR97	YR98	YR99	YR00	YR01	YR02
Percent Share in GDP											
Agriculture	14.6	15.8	21.1	18.4	17.6	18.7	21.1	24.1	27.3	22.1	22.0
Manufacturing	16.2	25.0	21.2	11.3	13.4	13.2	13.0	12.2	12.7	11.1	11.6
Mining	24.4	15.5	10.7	16.4	13.7	11.3	7.1	4.2	3.2	4.4	3.9
Construction	7.3	3.0	4.5	4.6	4.0	5.0	5.0	5.2	5.0	6.2	7.4
Energy	2.4	1.7	2.8	3.6	3.7	4.7	4.1	3.7	3.2	3.8	3.4
Services	35.1	38.9	39.6	45.7	47.7	47.1	49.7	50.6	48.6	52.3	51.7
Growth Rates, 1994 prices											
GDP	1.6	1.4	0.3	-2.5	6.6	3.3	-1.9	2.0	3.5	4.9	3.0
Agriculture	2.2	3.5	4.8	33.4	–0.6	–5.1	1.2	6.9	1.8	–2.4	–4.1
Manufacturing	4.5	3.6	1.8	–0.4	5.5	5.1	1.8	2.8	13.5	4.2	5.8
Mining and quarrying	–2.2	–0.8	–10.2	–27.5	2.8	2.2	–25.1	–24.8	–5.1	14.0	16.4
Construction	–1.9	–2.7	–3.2	–3.3	–11.0	29.0	–9.1	10.2	1.2	11.5	17.4
Energy	2.5	–2.0	2.8	–1.5	–5.6	4.2	0.6	2.6	1.1	12.6	–3.2
Services	–0.2	1.1	1.8	–2.3	15.0	4.0	4.3	6.6	6.0	4.9	3.2

Note: The 1990s average contribution of manufacturing appears high because of the very high inflation in the first half of the 1990s (not reported).
Source: World Bank.

From a long-term perspective, Zambia's growth record has been one of protracted decline (Table 2). The GDP growth rate fell from an average of 1.5 percent in the 1970s to 1.4 percent in the 1980s and 0.3 percent in the 1990s. Inflation increased steadily, on average, from around 10 percent in the 1970s to about 70 percent in the 1990s. The steady increase in inflation, coupled with population growth which was above the GDP growth rate, resulted in a decline in real per capita income of 1.6 percent per year since independence. In 2002, Zambia's per capita income at constant prices was only about 60 percent of its per capita income in the 1960s. The country has therefore gotten much poorer.

Among the reasons for Zambia's poor growth record are: (i) the poor performance of the copper sector and adverse terms of trade shocks; (ii) macroeconomic instability, in particular high inflation and high interest rates, which deterred private investments; (iii) the lack of timely structural reforms aimed at reducing the cost of inefficient public enterprises; and (iv) failure to realize anticipated benefits from privatization.

During the 1990s, Zambia undertook fundamental changes in its economic policy. Exchange and interest rates were liberalized, the trade reforms in 1995–98 simplified the tariff structure, removed quantitative restrictions, and transformed the Zambian trade regime into one of the most open in the sub-region; and, the Government successfully concluded debt reduction and rescheduling agreements with the Paris Club and reached the HIPC Decision point in December 2000.

Despite significant structural reforms, however, the economy continued to grow at a very low rate. Over the period 1995–2000, the GDP grew by an average of only 2.1 percent per annum, compared with an average population growth of 3.1 percent per year. Inflation averaged about 25 percent, reaching nearly 30 percent in 2000; in addition, domestic savings remained low, interest rates remained high, the current account deficit increased, and the exchange rate depreciated precipitously.

In 2000, Zambia's nominal external public and publicly guaranteed debt stood at about US$6.5 billion, more than twice the level of GDP (Table 2). As of 2000, debt service stood at 5.5 percent of GDP, or about 21 percent of the value of exports. On the domestic front, the fiscal deficit of the government averaged about 2.5 percent of GDP over 1995–2000, and stood at about 5.4 percent in 2000. The overall public sector deficit (quasi-fiscal deficit) in Zambia—which includes the deficits of the central government, the local governments, extra-budgetary accounts, state-owned enterprises, and the Central Bank—was estimated to be much higher at about 17 percent of GDP in 1997.[5] The high overall public sector deficit has in part continued to provide the structural basis for high inflation in the country.

Table 2. Zambia: Macroeconomic Indicators, 1970s–1990s (in percent unless otherwise noted)

	1970s Average	1990s Average	1980s Average	YR95	YR96	YR97	YR98	YR99	YR00	YR01	YR02
GDP Growth Rate	1.5	1.4	0.3	–2.5	6.6	3.3	–1.9	2.0	3.5	4.9	3.0
CPI Inflation Rate	10.2	36.1	70.9	35.2	45.2	24.5	24.4	26.8	30.1	21.7	22.2
Domestic Savings/GDP	33.2	14.0	7.1	12.2	5.3	9.4	3.9	–0.9	3.1	9.8	3.8
Investment/GDP	30.2	16.2	14.1	15.9	12.8	14.6	16.4	17.9	18.3	20.0	18.0
Interest Rate (lending rate)	7.8	16.0	54.7	45.5	53.8	46.7	31.8	40.5	38.8	46.2	45.2
Current Account Deficit/GDP (incl. Grants, percent)	–6.6	–10.8	–4.7	–4.2	–3.8	–8.0	–10.9	–8.6	–13.7	–13.0	–9.6
Exchange Rate (Kwacha/US$)	0.7	4.8	903.1	866.0	1,207	1,315	1,862	2,388	3,110	3,608	4,398
External Debt/GDP	64.5	171.9	204.1	200.7	215.5	170.2	212.0	209.7	216.8	168.8	168.1

Note: The 1990s average inflation rate was high because of the very high inflation in the first half of the 1990s (not reported).
Source: World Bank.

5. 1997 is the latest year for which estimates of quasi-fiscal deficits are available.

The macroeconomic performance since 2000 has been encouraging. In the aftermath of the sale of ZCCM, the economic outlook for the country brightened and a strong performance by the mining, manufacturing and service sectors led to a GDP growth rate of 3.5 percent in 2000, 4.9 percent in 2001, and about 3.0 percent in 2002. Fiscal and monetary performance continued to be satisfactory, and inflation, which stood at about 30 percent by the end of 2000, came down substantially and reached about 18.7 percent at end-2001 on account of prudent financial policies, decelerated food prices, and appreciation of the Kwacha. However, inflation rose to about 26.7 percent in 2002 on account of a rise in food (in particular maize) prices due the region-wide food crisis caused by drought.

Since 2000, Zambia faced three major challenges. First, the deterioration in the global economic environment due to the September 11 tragedy and the general slowdown in the world economy depressed the world demand for Zambia's major export commodities and tourism services, and reduced the foreign exchange earnings. Second, on January 24, 2002, Anglo-American Corporation (AAC) announced that it would not continue operating the Konkola Copper Mines (KCM), its joint venture, which comprised the major part of ZCCM's assets when it was privatized in 2000. This decision introduced considerable economic uncertainty in Zambia, as KCM produced about two-thirds of Zambia's total copper production. In August 2002, AAC and the Government reached agreement on a financing package that finalized AAC's withdrawal from the copper sector. The government is now searching for a strategic partner to run KCM on a commercially viable basis. Finally, Zambia's economic difficulties were compounded by a serious regional food crisis which began in May 2002. The food crisis was caused by drought in the previous production season, which severely reduced crop production and led to a significant shortfall (over 600,000 tons) of maize, Zambia's main staple crop, which had to be imported by the Government. Despite these difficulties, overall economic performance has remained favorable since 1999.

The overall macroeconomic picture that emerges is clear: while Zambia saw a significant progress in the area of structural reforms during the 1990s, full macroeconomic stability and sustainable growth have remained elusive. On the one hand, apart from areas like agriculture and energy, most major market distortions have been eliminated, the role of the government in commercial activities has been reduced, prices are largely market determined, and some of the previously state-owned enterprises have been restructured and divested to the private sector. On the other hand, Zambia's economy continues to exhibit weak and at best uneven growth, high inflation, very low savings rate, high real interest rates, a very weak external position, a high degree of dependence on copper production and exports, and a high degree of vulnerability to shocks. Needless to say, these have had adverse implications for trends in the poverty and social indicators of the country.

Progress in Poverty and Social Indicators

The trends in poverty and social indicators in the 1990s provides a useful context in which to discuss what public expenditures have or have not been able to achieve in Zambia during the same period, and what, if any, might be needed in the future. A brief review of Zambia's progress in poverty, education, and health indicators is provided below.

Poverty. Zambia's principal household surveys—the Social Dimensions of Adjustment Priority Surveys of 1991 and 1993, and the Living Conditions Monitoring Surveys of 1996 and 1998—show that, in general, poverty levels increased during the 1990s. Poverty incidence in 1998 was at 72.2 percent (versus 69.2 percent in 1996). Rural poverty was higher (82.7 percent) and was closely associated with geographic isolation, but poverty in urban areas was on the rise, at 54.8 percent (versus 46 percent in 1996) as a result of the economic deterioration in the second half of the nineties.

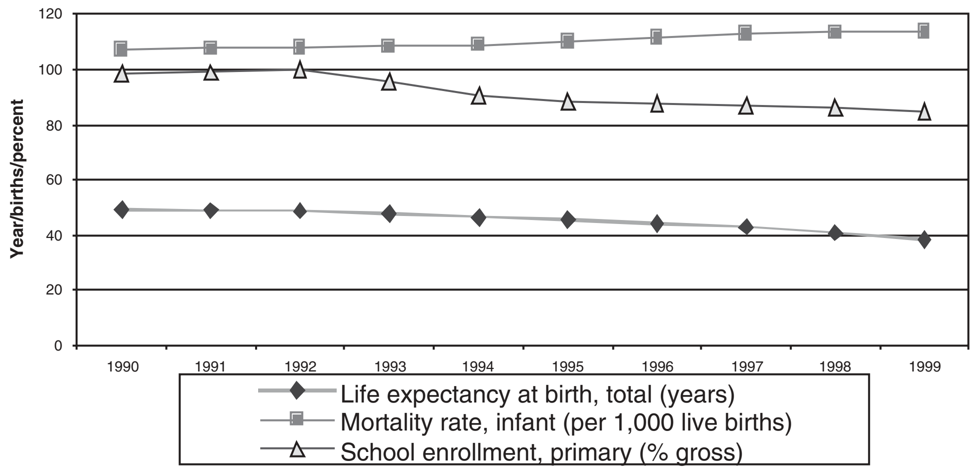
Both health and education indicators have deteriorated over the 1990s (Table 3). Infant mortality, adult illiteracy, and malnutrition remain extremely high. Furthermore, the rate of HIV/AIDS infection is high and has contributed to a sharp decline in life expectancy and a deterioration in health standards (Figure 1). Indeed, the HIV/AIDS epidemic is affecting all aspects of the social and economic fabric. Table 3 summarizes the progress in poverty and social indicators during the 1990s.

Table 3. Zambia: Poverty and Social Indicators (in percent unless otherwise noted)

	1991	1998
Poverty		
Extreme poverty—Zambia	58	58
Extreme Poverty—Rural/Urban		
Rural	81	71
Urban	32	36
Extreme Poverty—Province		
Central	56	63
Copperbelt	44	47
Eastern	76	66
Luapula	73	69
Lusaka	19	34
Northern	76	67
North-Western	65	63
Southern	69	60
Western	76	78
Education		
Net Primary School Enrollment Rate	83	72
Female	82	72
Male	84	73
Secondary School Enrollment		
Female	36	35
Male	55	49
Health and Nutrition		
Life expectancy at birth (years)	51	44
Under-5 mortality rate (per 1000 live births)	191	197
Under-5 stunting (low height-for-age)	39	53
HIV Infection (percent of adults)	—	20

Source: Zambia PER, November 2001; *World Development Indicators* (WDI), 2001 CD ROM.

Figure 1. Zambia: Trends in Health and Education Indicators, 1990–2000



Source: World Development Indicators Database.

Education. Zambia's enrollment rates for children of primary school age are below 70 percent in the rural areas. This is 10 percent lower than a decade ago. The lowest attendance rate for children of primary school age occur in the Eastern (48 percent), Northern (60 percent), Luapula (61 percent), Western (63 percent) and North Western provinces (65 percent).[6] The decline in education standards over the past decade and a half has resulted in low competency levels among the children and high illiteracy levels among the adult population with wide gaps between male/female and rural/urban sectors. Low enrollments of school-age children are largely due to the inability of their parents/guardians to meet the cost of schooling; perceived high opportunity costs of children as they are engaged in income generating activities or looking after sick family members; and poor learning environments due to poor infrastructure, inadequate supply of furniture and learning materials, and unmotivated and sometimes unqualified teachers.

Health and Nutrition. The key features of the health sector in Zambia are:

- High infant and under 5 mortality rates (Figure 1 and Table 3). As of 1998, the mortality rates were estimated at 114 per 1000 live births for infant mortality and 197 per 1,000 live births for under-5 mortality. Adult mortality rates stand at 597 per 1,000 for female, and 607 per 1,000 for male. These rates have recently been rising due to increased vulnerability to water-borne and infectious diseases, in particular HIV/AIDS, malaria, and diarrohoea.
- High malnutrition—according to the 1996 LCMS, malnutrition in rural Zambia had been 47 percent. In 1998, it worsened by almost 20 percent. Between 1991–98, stunting levels increased by 14 percent. The worst affected regions are the Northern, Eastern, Central, and Luapula provinces. These provinces are also character-

6. Living Conditions Monitoring Survey Report; 1998, Pg. 42.

ized by high poverty incidence. Levels of wasting are higher in urban areas owing to poor sanitation, crowding, as well as the absence of an extended support system for childcare. Women and children appear to be disproportionately affected as a result of higher biological nutrient needs. According to the 1998 LCMS, 10 percent of women are stunted due to protein energy malnutrition especially during pregnancy and lactation when physiological needs increase.

- The rural population exhibits a higher proportion of illnesses than the urban areas.

HIV/AIDS. The escalating HIV/AIDS pandemic, coupled with other infectious diseases like malaria and TB, is an urgent issue that impacts all sectors of the economy and society. In addition to their impact on health, education, and social safety nets, HIV/AIDS and other infectious diseases such as malaria and diarrhoea now constitute a key obstacle to future rapid growth in Zambia. These diseases are expected to significantly reduce skilled labor supply and productivity, savings and investment, and public revenue while at the same time increasing public expenditure on health. A preliminary analysis indicates that HIV/AIDS could depress Zambia's GDP growth by 1.5–2.3 percent a year on average (IMF 2001a). The key challenges in this area are prevention of further increases in the prevalence rate of HIV infections, care for those already infected and mitigation of the impact of HIV/AIDS on vulnerable groups especially orphaned children.[7]

Thus, in summary, over the last decade, most of Zambia's social indicators deteriorated. Poverty increased, particularly in urban areas; Zambia's enrollment rates for children of primary school-age decreased; illiteracy rates among adult population increased with widening gaps between male/female and rural/urban sectors; and mortality rates, both of children and adults, rose due to vulnerability to water-borne and infectious diseases, in particular HIV/AIDS and malaria.

Public Expenditure, Poverty and Social Outcomes

Macroeconomic stability and growth are essential for making progress in poverty and social outcomes. While macroeconomic stability is often a precondition, growth is a necessary condition for improving social outcomes. In the case of Zambia, the lack of sustainable growth above the average rate of population growth underpins the decline in social indicators. Over the past three decades, Zambia's real GDP has stagnated, representing a decline of about 3 percent a year in per capita terms and a significantly weaker performance than some countries in the region. This stagnation has been one of the major causes of increase in poverty and deterioration in social indicators.

However, while necessary, growth alone is not sufficient to reduce poverty and improve social indicators. Among factors determining the rate at which growth translates into poverty reduction and improvements in social indicators are: patterns of growth, income

7. According to the 1998 LCMS, of all children under age 20, about 16 percent have lost one or both parents. Among children of primary school age, the share of maternal or double orphans is projected to reach 14 percent in 2002, 16 percent in 2006, and 19 percent in 2010.

distribution, public expenditures, institutions and service delivery mechanisms, regional equity and political representation, household income and demographic characteristics, social policy, and the extent of unforeseen shocks affecting households.[8]

Trends in Social Expenditure

Public expenditure is the connecting thread between macroeconomic stability and growth on the one hand and improvements in social outcomes on the other. Without macroeconomic stability and sustainable growth, it would be difficult for any government to sustain a level of public expenditure that would be adequate to finance key social services.

In Zambia, social expenditures, defined in a specific way,[9] are protected in the budget and by the conditions of the World Bank's lending operations at 36 percent of the total domestic discretionary budget. As a result of the introduction of such protection in the mid-1990s, social sector expenditures increased from 22 percent in 1991 to 36 percent in 1996, and have remained more or less at that level since (Table 4). Two points should be noted with respect to the size of social sector expenditures in the 1990s. First, although the Government has maintained the nominal 36 percent share in the second half of the 1990s, social sector expenditure have fallen in real terms because of the relatively high inflation rate in Zambia (around 25 percent in 2002). Second, rural infrastructure investments—which are particularly closely related with growth and income opportunities for the poor—have fallen in the 1990s due to both the inability of the government to make long-term commitments as well as the significant shortfall of actual to budgeted resources (Zambia PER, 2001).

Table 4. Zambia: Share of Social Expenditures, 1996–2001 (percent of domestically financed discretionary spending)

	1996	1997	1998	1999	2000	2001
Education and training	18	18.3	17.4	18.5	23	20.2
Health	13	12.9	13.1	13.7	10.6	13.1
Social security and welfare	1.3	1.6	1.1	1.2	0.6	2.9
Water and sanitation	3.1	1.6	2.4	2	0.6	1.4
Other social expenditure	0.3	0.1	0.2	1.1	0.2	0.5
Total social expenditure	35.8	34.4	34.2	36.4	35.0	38.1

Source: Ministry of Finance and National Planning; *Zambia PER,* 2001.

8. See, for example, *World Development Report 2000/2001: Attacking Poverty.* World Bank, Washington, D.C.

9. Social sector expenditure is defined as current and capital expenditure on health, education, social safety net, water and sanitation, and disaster relief. Domestically financed discretionary expenditure is defined as total expenditures, less foreign-funded expenditure, domestic interest payments, the allocation for arrears clearance, the civil service wage adjustments, the contingency reserve, civil service retrenchment costs, payments to the Public Service Pension Fund, net lending to ZCCM, and court awards made against the Government.

Efficiency and Equity of Social Expenditures

However, improvements in social outcomes depend not just on the size of resources allocated, but also on the efficiency and equity of social expenditure. In this respect, the conclusions of the recently completed Zambia Public Expenditure Review (2001) offer a number of important insights.

Efficiency of Social Expenditures. The findings of the recently completed Zambia Public Expenditure Review (PER, 2001) indicate that the delivery of public services in health and education facilities has been seriously affected by the cash rationing system, which is characterized by substantial unpredictability and volatility of expenditures (in the sense that the quarterly allocations confine the planning horizon for programs and activities ex-ante, and outturns significantly deviate from budget ex-post). In addition, there exists lack of transparency and expenditure wastage. Proficiency and procurement guidelines are there but oftentimes flouted. For example, transparency in the procurement of pharmaceuticals and fertilizers remains a serious problem, and there is a wasteful duplication of functions and staff between parallel agencies—for example, between the Ministry of Health and the Central Board of Health. There are also weak fiscal controls and financial and procurement management, which reduce the money that gets to the final consumer.

Benefit incidence of social expenditures. Again, the findings of the Zambia PER suggest that:

- Spending on primary education is generally pro-poor. Secondary education shares this pattern, though the effect is not as pronounced as in primary education. The beneficiaries of the substantial subsidies to university education are not the poor.
- The beneficiaries of health expenditures are generally more complex and less clear. The largest group using public primary health facilities tends to be in the middle of the income distribution, not at either end. In addition, expenditures on hospitals almost certainly benefit the non-poor more than others.

Yet public provision of social services constitutes only part of the equation in improving social outcomes. Demand or household factors are often as critical. Principal among factors determining households' investment in their own health and education are behavior, income, service quality, physical access, price, gender, and supply in related sectors.[10] While our empirical knowledge on the demand side constraints in Zambia is rather limited, available evidence indicates that low income, cost recovery schemes, poor physical infrastructure, gender inequalities and income distribution within a household, and factors outside health and education sectors—such as availability of food, clean water and sanitation services, and the environment—all constrain the poor in accessing health and education services. Data from the Demographic and Health Survey reveal that about 20 percent of Zambian adults engage in behaviors known to be highly risky for HIV transmission. This has contributed markedly to poor health outcomes. Through the growth of the orphan population, it also has had an impact on the education, health, and nutrition outcomes for Zambian children.

10. A good summary of the role of these factors in the context of some African countries is provided in Castro-Leal et al. (1999).

In summary, Zambia made some effort in the 1990s in increasing and subsequently maintaining the nominal shares of education, health, social welfare, and other social expenditure in the domestically financed discretionary budget. The share of the combined social sector expenditures increased from 22 percent in 1991 to 36 percent in 1996, and has remained more or less at that level since. However, due to lack of growth and full macroeconomic stability, social expenditures have fallen in real terms. The decline in real financing may have partly contributed to the deterioration in social outcomes and increased poverty witnessed in the 1990s. However, it is not just a decline in real financing that is at the root of the latter; evidence shows that poor public expenditure management and financial accountability, low public sector efficiency and poor quality of services, and the HIV/AIDS pandemic have all considerably contributed to the worsening trends in social indicators and poverty. In addition, demand side factors acted to exacerbate this trend by limiting households' investments in their own health and education.

The Scope for Increasing Government Revenue

Structure and Composition of Revenue

The two major components of Central Government's revenue in Zambia are domestic revenues and external grants. Table 5 provides historical data on the trends and components of Government revenue in Zambia. Revenue as percent of GDP averaged 19.3 percent of GDP in the 1990s, and grants accounted for about 8.7 percent of GDP. Foreign grants accounted for the bulk of the total share, showing Zambia's high level of dependency on external financing. The decline in tax revenue and the fluctuation of non-tax receipts (which included income from parastatals) were always matched by offsetting and rising grants, which ranged from 4.3 to 14.7 percent of GDP.

Zambia's main sources of tax revenue are income tax (consisting of both personal and corporate tax), VAT/sales tax, excise tax, import duties, and other taxes. In 1990s, total tax revenue averaged 18.4 percent of total revenue, which was above the average for the countries in sub-Saharan Africa (SSA). The SSA average, excluding South Africa, was 15.6 percent. Tax revenue accounted for about 95.7 percent of total revenue in Zambia. Of the total tax revenue, income tax accounted for 35.3 percent; trade taxes for 31.5 percent; VAT/sales tax for 15.8 percent (currently at 17.5 percent); and excise taxes for 16.5 percent.

Individual Income Tax. Zambia's personal income tax system is progressive, with tax rates of 10, 20, and 30 percent depending on individual income. According to a recent IMF study (2001b), not only have the values of the tax threshold and rate bands been progressively eroded but also the threshold and rates of the individual income tax are inequitable.

Business Income Tax. The general rate of corporate income tax is 35 percent, but many companies are liable to different rates depending on sector or activity: companies listed on Lusaka Stock Exchange pay 30 percent; banks pay 35 percent if their income is less than K250 million and 45 percent if their income is more; and farming and non-traditional exports to 15 percent. These multiple tax rates under the business income tax distort resource allocation, distort investment and capital flows, and increase the burden of tax administration. In order to reduce these distortions, it may be necessary to unify the business income tax rates, except for the tax on the financial sector.

Table 5. Zambia: Central Government Revenue, 1990–2000

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	Average
Central Govt Revenue as % of GDP												
Revenue and grants	24.6	32.9	33	26.3	30.2	29	26.8	25	25.4	25.9	27.9	27.9
Revenue	20.3	18.7	18.4	15.9	20.1	19.9	20.7	19.9	18.8	17.9	21.6	19.3
Tax revenue	19.9	18.3	17.5	15.3	18.7	18.2	19	18.8	18.1	17.4	21.3	18.4
Income taxes	7.8	6.6	6.5	5.5	6	6.3	6.2	6.4	6.6	6.5	7	6.5
Excise taxes	2.9	3.6	2.7	2.2	3.1	2.8	3.2	3.3	3.5	3	3.1	3.0
Value-added taxes (VAT)	1.9	2.1	2.2	2.3	3.4	3.6	3.5	3.6	3.3	3.3	2.5	2.9
Trade taxes	7.3	6.1	6	5.3	6.2	5.4	6.1	5.6	4.7	4.5	6.6	5.8
Clearance of tax arrears	0	0	0	0	0	0	0	0	0	0	2.1	0.2
Non-tax revenue	0.4	0.4	0.8	0.5	1.4	1.7	1.6	1.1	0.6	0.5	0.2	0.8
Grants	4.3	14.2	14.7	10.5	10.1	9.2	6.1	5.1	6.6	8.1	6.4	8.7
Structure of Central Govt Revenue												
Revenue and grants, % of Total Expenditures	74.8	81.9	88.7	73.5	79.2	88.3	98.1	99.0	88.6	92.6	96.6	87.4
Revenue, % of Revenue and Grants	82.4	56.8	55.6	60.3	66.5	68.4	77.2	79.7	74.0	68.9	77.2	69.7
Tax revenue, % of Revenue	98.2	97.9	95.5	96.6	93.2	91.6	92.0	94.6	96.7	97.4	98.9	95.7
Income taxes, % of Tax Revenue	39.1	35.9	37.2	35.8	32.0	34.9	32.6	33.8	36.4	37.4	32.8	35.3
Excise taxes, % of Tax Revenue	14.5	19.5	15.6	14.6	16.8	15.5	16.9	17.4	19.3	17.2	14.4	16.5
Value-added taxes (VAT), % of Tax Revenue	9.7	11.5	12.8	15.1	18.2	19.7	18.2	19.0	18.3	19.2	11.9	15.8
Trade taxes, % of Tax Revenue	36.8	33.1	34.5	34.5	33.1	29.9	32.3	29.8	26.0	26.1	30.9	31.5
Clearance of tax arrears, % of Tax Revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	9.9	0.9
Non-tax revenue, % of Revenue	1.8	2.1	4.5	3.4	6.8	8.4	8.0	5.4	3.3	2.6	1.1	4.3
Grants, % of Revenue and Grants	17.6	43.2	44.4	39.7	33.5	31.6	22.8	20.3	26.0	31.1	22.8	30.3

Source: MOFNP; *Zambia PER,* 2001.

Value-added Tax (VAT). The VAT in Zambia is mainly a consumption tax, with a zero rating for exports, some agricultural products, food, medical supplies and drugs. Introduced in 1995 with a 20 percent rate, the VAT replaced an earlier sales tax which was levied at 23 percent. However, since its introduction, the VAT base has been eroded, and its administration weakened. This has arisen from zero rating previously exempted products, exempting additional ones, and registering a large number of taxpayers with a turnover below a very low threshold. The five broad groups of zero-rated supplies under the VAT in Zambia are foods and agriculture, export of goods, supplies to privileged persons (for example, president, diplomats, donors) medical supplies, and tourism sector and hotels in the Livingstone district. The current VAT level is 17.5 percent.

Scope for Increasing Tax Revenue

In the short to medium term, the scope for significantly increasing government revenue is rather limited. Zambia's tax revenue, expressed as a percentage of GDP, averaged slightly over 19 percent in the 1990s (see Table 5), which compared very well to countries in Sub-Saharan Africa. The SSA average, excluding South Africa, is 15.6 percent, Malawi 14.3 percent, Mozambique 11.0 percent, and Uganda 8.3 percent (World Bank, 2001b). Furthermore, Zambia's tax effort is good relative to countries in the region: its tax system is well designed and managed by qualified headquarters staff. Raising the revenue effort any higher would therefore likely be difficult without addressing the growth of the tax base. Without sustainable growth to help expand the tax base, and thereby increase the tax revenue, the capacity of the government to increase social expenditure (in real terms) is limited. A recent IMF study (2001b) concludes that while some enhancements can be made to the Zambia tax revenue, efficiency gains from tax reform are likely to be limited mainly to improvements in tax administration (IMF 2001b).

Key Areas for Maximizing Impact of Public Expenditure

Given the limited scope for increasing revenue, two broad areas remain central to increasing the impact on poverty through public expenditures in the years ahead. The first is to refocus domestic resources toward poverty reduction by deepening structural reforms, in particular reforms of inefficient state-owned enterprises. Such reforms are fundamental to promoting better utilization of Zambia's otherwise extremely limited public resources. The second is to ensure a more effective and transparent utilization of existing resources. Each of these is briefly discussed below.

Reducing the Fiscal Drain of Parastatals

As noted above, Zambia has moved from a position of state-dominated economy and government administered price structures and protective mechanisms in the early 1990s to a position today of an open economy characterized by market-determined prices and far less state domination in the economy. Indeed, some of the key state-owned enterprises have been restructured and divested to the private sector, including the copper company, Zambia Consolidated Copper Mines (ZCCM).

ZCCM's privatization in March 2000 marked a new era in Zambia's economic history for two main reasons. First, the transfer of copper assets into the private hands is expected to lead to more efficiency and better production in the copper sector. There are already indications that the privatization has led not only to revival of Zambia's copper production, but also to better investment in services, tourism, and construction in the Copperbelt area. Second, in view of its huge financial losses, the sale of the ZCCM constituted a major step toward reducing the flow of overall public sector deficit. Yet, the privatization of the ZCCM left behind a stock of debt—estimated at about US$588 million as of March 2000—much of which still needs to be settled by the Government.

However, although a major drain on public resources at the time, ZCCM was not the only parastatal claiming a significant amount of public resources. Other parastatals contributing to the fiscal drain on public budget included the Zambia National Oil Company (ZNOC), Zambia Electricity Supply Company (ZESCO), Zambia Railways (ZR), and TAZARA and TAZAMA.

Deepening of the structural reforms in the above areas is important for three main reasons. First, a stable macroeconomic and fiscal environment is not possible without further reduction of the losses of major parastatals that continue to claim significant public resources, and thereby crowd out the much needed poverty-focused public spending in Zambia. Without structural reforms, not only will Zambia's growth record remain uneven, but also the high quasi-fiscal deficit[11] will continue to provide the structural basis for high inflation and macroeconomic instability in the country. Second, without macroeconomic stability and growth, it is difficult to expect that the decline in real government expenditure seen in the 1990s in general and those on health and education in particular will be reversed. Without a decent improvement in real per capita spending on vital social services such as health, education, water and sanitation, and infrastructure, it is in turn difficult to expect improvements in social outcomes.

It should be pointed out that several of the needed structural reforms are already underway. In 2000, the Bank's FSC1 initiated key reforms with respect to a number of key parastatals as well as the major pension funds in the country. The Government is proceeding with the reform of the electricity utility, ZESCO, through commercialization to ensure its efficient operation, protection from political interference as well as its independence from budgetary resources including commercial debt guarantees. In the oil sector, the Government has liquidated ZNOC and allowed the private sector to freely import crude oil, and agreed to the formation of an oil price consortium for importation of feedstock. However, it is yet to offer for sale or long-term concession the Ndola storage tank; as well as the TAZAMA pipeline. In the railway sector, the concessioning is not yet completed. The immediate challenge is to complete these reforms.

Past pension reforms, in particular of the National Pensions Scheme Authority (NAPSA), have promoted cost efficiency measures to reduce administrative costs, set up a transparent governance structure, and restructured the contribution and benefit parameters to ensure long-term sustainability. However, the Public Service Pensions Fund (PSPF) remains to be reformed to restore financial sustainability.

11. A preliminary ongoing work on estimation of fiscal and quasi-fiscal deficits in Zambia shows that the overall public sector deficit of Zambia, including deficits parastatals, pension funds, and extra-budgetary funds, stood at around 19 percent of GDP in 1999 (World Bank, AFTP1).

Increasing the Efficiency and Effectiveness of Current Public Expenditures

Countries show enormous variation in the efficiency with which public expenditures are used to improve poverty and social outcomes.[12] In Sub-Saharan Africa, for example, while the per capita health spending of Zambia and Côte d'Ivoire is almost equal (US$24 per person in PPP terms in 1997), the outcome of that spending in terms of a key indicator of health—the infant mortality rate—is significantly different for the two countries (113 per thousand for Zambia but only 87 per thousand for Côte d'Ivoire). The underlying factors for such significant variations in outcomes for similar levels of spending are rather complex. However, broadly, the inter-sectoral and intra-sectoral allocations of budget, the efficiency with which budgets are executed, whether there are clear and transparent financial management and accountability systems in place, and whether the procurement systems are efficient and transparent are all critical ingredients.

As pointed out earlier, the delivery of public services in Zambia has been seriously affected by the cash rationing system, which is characterized by substantial unpredictability and volatility of expenditures—that is, quarterly allocations which confine the planning horizon for programs and activities ex ante, and outturns significantly which deviate from budget ex post. In addition, there is lack of transparency and expenditure wastage at different levels of public spending, weak fiscal controls and financial and procurement management, and lack of financial accountability. All of these point to the need for improving the efficiency and effectiveness of current public expenditure in order to have better impact on poverty and other social outcomes.

Summary and Conclusions

During the 1990s, Zambia made significant progress in the area of structural reforms: major market distortions have been eliminated, the role of the government in commercial activities has been reduced, prices are largely market determined, and some of the previously state-owned enterprises have been restructured and divested to the private sector. However, full macroeconomic stability and sustainable growth have remained elusive. Zambia's economy still continues to exhibit weak and at best uneven growth, high inflation, very low savings rate, high real interest rates, and a very weak external position.

Zambia's social indicators mostly deteriorated during the same period. Poverty increased in urban areas; Zambia's enrollment rates for children of primary school-age decreased; illiteracy rates among adult population increased with widening gaps between male/female and rural/urban sectors; and mortality rates, both of children and adults, rose due to vulnerability to water-borne and infectious diseases, in particular HIV/AIDS, malaria, diarrhea, TB and respiratory diseases.

12. For example, a WHO report (2001) which compares health performances across the nations of the world, finds that although the United States spends considerably more on healthcare per person than any other nation, it ranks only 15th among countries of the world on an overall health performance index. On the other hand, Oman, with US$334 in per capita health spending, ranks no. 1 in the world in life expectancy for its investment. Chile and Lebanon have virtually the same per capita spending (about US$570 per year), but Chile ranks 33rd in overall performance while Lebanon ranks only 91st.

Zambia made considerable effort in the 1990s to increase and subsequently maintain the nominal shares of education, health, social welfare, and other social expenditure in the domestically financed discretionary budget. In nominal terms, the combined share of social sector expenditures increased from 22 percent in 1991 to 36 percent in 1996 and has remained more or less at that level since. However, in real terms, the overall government expenditure as well as expenditure on health education, and other vital social services declined during the same period. The lack of adequate financing was thus partly to blame for the deterioration in social outcomes and increased poverty seen in the 1990s. In addition to the shrinking real per capita public expenditure, evidence shows that poor public expenditure management and financial accountability, low public sector remuneration and efficiency, and poor quality of services have considerably contributed to the worsening trends in social indicators and poverty.

Without a sustained growth and an expansion in the tax base, the scope for increasing government revenue—and therefore the size of public expenditure—in Zambia is limited in the short to medium term. Given the limited scope for increasing public expenditures, two broad areas are likely to remain central in this effort: (i) the need to refocus domestic resources toward poverty reduction by deepening structural reforms, and (ii) the need to ensure a more efficient, effective, and transparent utilization of existing public expenditures. These efforts can be accomplished by deepening the structural reforms that are already underway, as well as launching of new reforms in the areas of budget preparation, allocation, and execution. Without better budget management, accountability and boosting of value-for-money, the impact on poverty of any amount of resources will at best remain limited.

Better and improved budget management and accountability at the central level (for example, ministry of finance) alone is no guarantee that inefficiency and wastage of resources will disappear at the ministerial level and down-stream. Thus in order for public expenditure to generate improvements in social outcomes on the ground, effective budget management needs to be extended to the second (ministerial and provincial) and third levels (that is, service centers) of budget management. This in turn requires effective institutions, financial management and clear line of accountability and transparency in resource management, an effective procurement system, and better service delivery.

CHAPTER 3

Governance and Accountability in Zambia

The quality of governance and the institutional structures that support it have a significant impact on the effectiveness of public expenditures. While the bulk of this report focuses on the dimension of governance often referred to as "administrative" governance, in effect, the effectiveness of government in providing public services, political, and economic governance are vital as well. Political governance reflects concerns over national security, stability of the political system, rule of law, separation of power, and the democratic process generally. Economic governance includes economic policies, the state-market relationships, and the environment created by government for private sector activity. This chapter establishes the broader context in which public sector effectiveness must be viewed and provides an overview of Zambia's governance over the recent past. Though the data tends to paint a disappointing picture, it should lend strength and credibility to the current Government strategy to attack corruption, to enhance the rule of law, and to re-invigorate the role of Parliament in improving public accountability. The chapter concludes with a discussion of specific steps that can be taken to strengthen public accountability and voice by addressing Parliament's role in economic management. With the Government having embarked upon a Constitutional review, a unique opportunity exists for the nation to build more effective mechanisms for improving transparency and accountability.

Trends in Governance Indicators

Like the macroeconomic environment, the quality of governance has generally declined in Zambia during the late 1990s. Although it is difficult to come up with a concise quantitative measure of governance, one of the best guides may be the World Bank's Governance

Research Indicator Country Snapshot (GRICS). The GRICS examines Governance according to six indices (1) Political Stability/No Violence, (2) Voice and Accountability, (3) Government Effectiveness, (4) Regulatory Quality, (5) Rule of Law, and (6) Control of Corruption. As Table 6 shows, under all but one of these dimensions, Zambia has been either steady or declining in its ratings. From 1997/98 to 2000/01, Zambia improved in terms of Regulatory Quality and remained unchanged in terms of Rule of Law. In all other dimensions, Zambia's scores declined over the period.

Zambia's worst governance scores have been in "Control of Corruption" and "Government Effectiveness" respectively. On a scale from 0 to 100 (with 100 being the best), Zambia's percentile rank in "Control of Corruption" was only 19.9. In "Government Effectiveness" it was only 26.9. In contrast, in Regulatory Quality, where Zambia scored highest in 2000/01, the percentile ranking was 69.8. These statistics serve to highlight the importance of PEMFAR because among the six dimensions of governance in the GRICS, it is the two on which Zambia scores worst that are the central focus of PEMFAR.

Table 6. Zambia Governance Trends

	POINT ESTIMATES (Worst:–2.5, Best:+2.5)		PERCENTILE RANK (Worst:0, Best:100)		
	1997–98	2000–01	1997–98	2000–01	Trend
Political Stability/No Violence	0.00	–0.42	49.4	32.7	⬇
Voice & Accountability	–0.05	–0.17	53.4	46.0	⬇
Government Effectiveness	–0.40	–0.75	36.9	26.9	⬇
Regulatory Quality	0.25	0.49	56.9	69.8	↗
Rule of Law	–0.40	–0.39	38.9	42.4	➡
Control of Corruption	–0.61	–0.87	28.2	19.9	⬇

Source: World Bank, *GRICS II, 2000/01: Governance Research Indicator Country Snapshot, II http://www.worldbank.org/wbi/governance/govdata2001.htm or http://info.worldbank.org/governance/kkz/*

Underlying Factors for Trends in Governance

Political Stability. External threats are a clear impediment to good governance because they promote political instability and encourage a diversion of scarce resources to the maintenance of national integrity. Conflicts on the border with Angola and in DRC have in the past contributed to a weakening in this area. Internal conflict can also have a bearing on this dimension of governance. Although Zambia's transition from one-party to multiparty rule in 1990 was peaceful, the political situation has not been entirely stable. A state of emergency was declared in 1994; political tension also increased after the Constitution was amended to block the former President, Dr. Kaunda, from contesting the 1996 election; and a failed military coup attempt in October 1997 was followed by repressive measures against opposition parties. Then, in the run up to the 2001 elections, President Chiluba's attempt to run for a third term resulted in widespread factional struggles within and across the major parties.

Voice and Accountability. Election processes, civic participation, and decentralization all have a bearing on the concepts of voice and accountability. Popular support for democracy is very high in Zambia despite limitations to full-fledged democratization. According to the Afrobarometer Survey in 1999, which is a comparative opinion survey conducted in Zambia and eleven other African countries, 74 percent of Zambian respondents expressed that democracy is always preferable to any other system of government. But in general, the institutional linkage between the citizen and the state through formal political process appears to still be weak in Zambia. This is reflected in another Afrobarometer survey, which showed that Zambians were the most pessimistic among sub-Saharan African countries surveyed[13] about the ability of their vote to change the government and to make their life better. On the other hand, non-government organizations (NGO's) are active and open, and are frequently consulted by Government.

Although many believe that institutions that are geographically closer to the citizens they serve will do a better job of delivering services, this has not been the case in Zambia. Local governments remain extremely weak, with district councils lacking autonomy or capacity to raise much of their own revenue.[14] The autonomy and discretion of local government have also been undermined by continuous central control and interference by the centrally-appointed District Administrators. Perhaps, as a consequence of this, the Zambian people *least* trust the local government to do the right things among other governmental institutions and there is a wide-spread dissatisfaction with performance of the local governments as evidenced by the Afrobarometer Network survey (see Table 7).

Government Effectiveness. Improving the effectiveness of the public sector is the central theme of the PEMFAR. Its importance is underscored by a widespread dissatisfaction among Zambian citizens about government's performance. According to the Afrobarometer survey (Table 7), the percentage of Zambians who are dissatisfied with government performance significantly exceeds those who are satisfied for all of the areas surveyed. In general, people seem to think that the government has performed worse in resolving economic problems (for example, employment and price stabilization) than for social services (such as security, health, and education).

Regulatory Rules. As noted in the previous chapter, the Zambian government has been making a slow but steady progress in economic reforms, such as deregulation of price controls, liberalization of trade, and the privatization of state-owned enterprises. Between 1993 and November 2002, 254 parastatals out of a portfolio of 280 had been privatized. Privatization of state-owned Zambia Consolidated Copper Mines (ZCCM) in 2000 is perhaps the most prominent achievement. Trade liberalization has been vigorously pursued since 1992, with all licensing and quantitative restrictions on imports and exports having been eliminated. The level and dispersion of customs duty rates, which ranged from 0 to 100 percent prior to 1991, was narrowed to 0 to 25 percent. The tariff bands were reduced from 11 to 4, and the exchange rate regime was fully liberalized. Overall, businesses in Zambia tend to face more obstacles in tax policies and administrative regulation than in trade or licensing policies.

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13. The other countries included in the survey are: Botswana, Ghana, Lesotho, Malawi, Namibia, Nigeria, South Africa and Zimbabwe.

14. Some of the means for councils to raise revenue were taken away by central government—e.g., the sale of council houses, the collection of market levies. In addition, local water and sanitation departments were commercialized.

Table 7. Public Perception about Government Performance

Afrobarometer Survey Questions How well would you say the government is handling the following problems:		Zambia	Botswana	Zimbabwe	Malawi	Lesotho	Namibia	S. Africa
Creating Jobs	Fairly/Very Badly	**72**	46	77	67	53	51	89
	Fairly/Very Well	**26**	52	20	31	38	47	10
Keeping Prices Low/Stable	Fairly/Very Badly	**70**	47	84	92	57	51	80
	Fairly/Very Well	**28**	41	14	8	20	38	17
Narrowing Income Gaps	Fairly/Very Badly	-	-	-	-	-	-	69
	Fairly/Very Well	-	-	-	-	-	-	23
Reducing Crime	Fairly/Very Badly	**63**	35	66	78	49	51	82
	Fairly/Very Well	**35**	64	31	22	44	47	18
Addressing the Educational Needs of All Citizens	Fairly/Very Badly	**56**	26	50	37	32	33	49
	Fairly/Very Well	**43**	72	46	62	56	62	49
Improving Health Services	Fairly/Very Badly	**62**	29	63	54	39	35	54
	Fairly/Very Well	**37**	70	35	46	50	63	43
Fighting Corruption in Government	Fairly/Very Badly	-	-	-	-	-	-	66
	Fairly/Very Well	-	-	-	-	-	-	30
Fighting HIV/AIDS	Fairly/Very Badly	-	-	-	-	-	-	57
	Fairly/Very Well	-	-	-	-	-	-	38

Source: The Afrobarometer Network, "Afrobarometer Round I: Compendium of Comparative Data from a Twelve-Nations Survey" Afrobarometer Paper. No. 11. Michigan State University, East Lansing, MI. Table 2–3, p.23; 2002.

Rule of Law. The statutory framework, human rights, and the judiciary system have each suffered some setbacks in the late 1990s (Table 6). The 1996 Constitution embodies the doctrine of the separation of powers, guarantees the independence of the judiciary, and circumscribes the power of the judiciary to pronounce legislation unconstitutional. It is widely agreed that the Zambian judiciary has been able to preserve its independence fairly successfully. However, a 1996 amendment to the Constitution is believed to have been motivated by political considerations. It has been observed that Zambia's constitutions "have been and remain flawed through the presence of 'savings clauses,' exceptions to each of the enumerated rights, exceptions conferring wide executive and legislative discretion" (Ndulo Muna and Kent 1998). They go on to express concern over freedom of the press and freedom from discrimination, especially for women. The new Government has initiated a constitutional review process, which could help to address the current weaknesses including public accountability.

With respect to the judiciary, its functional capacity is severely limited by a shortage of trained jurists and infrastructure constraints. Poor salaries are the most cited reason for the Government's inability to fill the vacancies. Most courts also lack adequate facilities for courtrooms. In the World Business Environment Survey (WBES) conducted by the World Bank with private businesses, most respondents express moderately high trust in the integrity of the judicial system (fairness and honesty), but overwhelming dissatisfaction with the timeliness of the judicial process (quickness). Judicial under-capacity also results in a backlog of cases in the criminal court system, which in turn results in very long pre-trial detentions and possible violations of human rights.

Control of Corruption. Transparency International ranks Zambia as 77th out of 102 countries in its Corruption Perceptions Index (CPI) for 2001. But what may be equally telling are Zambian's perceptions of corruption. According to an Afrobarometer survey conducted in 2002, it is widely believed that corruption was worse under the Chiluba government than that of Kaunda (only 28 percent view corruption as having declined). The privatization program has been a particular source of concern among Zambians, many of whom feel that it was conducted in a way that permitted some political officials to amass personal fortunes. The ZCCM Luanshya Mine sale, in particular, is cited as one which lacked adequate transparency in the selection process. Likewise, surveys have shown the occurrence of graft in public procurement. The WBES survey indicated that 70 percent of business respondents say that firms in their industry customarily make additional or unofficial payments to secure government contracts. This was a higher percentage than the survey found to be the case in five other southern Africa countries (Botswana, Malawi, Namibia, South Africa, and Zimbabwe). Only Madagascar had a higher percentage of respondents offering bribes.

To its credit, Zambia appears to be turning the corner. The new Mwanawasa government has made the fight against corruption a top priority, and has rejuvenated relevant institutions such as the Anti-Corruption Commission and the Prosecutions Division. However, it will take some time before this will be reflected in improved governance.

In its Poverty Reduction Strategy Paper (PRSP), the Government recognizes that good governance, especially economic and political governance, go hand in hand with effective poverty reduction. In the PRSP, the definition of poverty is expanded to encompass "exclusion from participation in institutions and processes that govern one's life, leading to voicelessness and powerlessness in these processes and institutions." Following from this, the Government identifies three key objectives for good governance that are part of its poverty reduction strategy. The first objective is to democratize decision-making through wider use of the consultative process. The PRSP process has helped the Government enhance the normal checks and balances among branches, especially by empowering the legislative and the judiciary in preventing corruption. Priority is also given to empowering local and traditional authorities, and to strengthening institutional linkages between local authorities and communities. The second objective is to ensure efficient, equitable, and transparent management of public resources. The third objective is to guarantee justice for all by advancing human rights, improving the efficiency of the legal system, and implementing constitutional and legal reforms. Since the development of the PRSP, the Government has taken steps to begin the constitutional review process, which in turn, could address a number of the current weaknesses in public accountability.

The Accountability Framework in Zambia

One of the most important issues facing Zambia is the inconsistency between the legal framework for public finance and the actual structures and incentives in place to assure accountability. This is reflected first in the fact that the Constitution seems to grant an excessive amount of discretion and authority to the Ministry of Finance. Typically, in a system with democratic control of public expenditure, Parliament approves the budget presented by the Executive as well as any major changes that are needed during the budget year. In contrast, under the current financial provisions in the Zambian Constitution, the Ministry of Finance is granted the power to make sweeping changes in the budget allocations without any prior consent of Parliament (see section below on constitutional issues). A review of other Constitutions and Finance Acts in Anglophone Africa provides important insights on how Zambia might achieve a better balance.

Secondly, even where the financial provisions are appropriate, they hinge upon a system of enforcement and accountability that has not functioned in practice. The current public finance rules are based on an assumption that the Ministry of Finance plays a primary role of stewardship or guardianship over the public purse and that it enforces an adherence to the rules by line ministries. However, Ministry of Finance has not held Controlling Officers accountable for their management of public resources, nor has the Parliament generally been in a position to hold the Executive accountable. As subsequent chapters of this report will show, without these checks and balances the system simply breaks down.

This section of the report provides a brief overview of the legal framework, describes some of the major weaknesses that exist within the financial provisions of the Constitution, and discusses ways in which the role of Parliament could be enhanced to provide an adequate system of oversight.

Description of the Legal Framework

The legal framework in Zambia is a three-tiered system with the Constitution at its apex.

The Constitution. The Constitution, last revised in 1996, articulates the respective roles and responsibilities of the Legislature, the Judiciary, and the Executive in all matters, including financial matters. Articles 114–121 of the Constitution give the Parliament powers to establish taxes and to authorize expenditures. The Articles define the financial management roles of the President as the head of the Executive, the minister in charge of finance (M-MFNP), and the Auditor-General of the Republic (AG). They set the framework for estimates, government expenditures, and other charges to the general revenues. The Articles provide for annual appropriation acts, supplementary and “excess” estimates, and supplementary and “excess” expenditure acts. Article 122 defines the AG’s tenure of office and the procedures for his removal.

The Finance Act—Chapter 347 of the Laws of Zambia. The Finance (Control and Management) Act defines the roles and responsibilities for Financial Management within the Executive. It gives the Minister of Finance the responsibilities for the management, supervision, control and direction of all matters relating to the financial affairs of the republic and allows him/her to designate a Controlling Officer (CO) for each expenditure head provided for in the annual budget. The Act makes the CO the Chief Accounting Officer and charges him/her with the duty of controlling the resources under the relevant head, subject to directions given by the Permanent Secretary (PS-MFNP). It also allows the CO to delegate some responsibilities to any accounting officer (AO) under his/her responsibility, and to provide the latter with necessary directions to secure the proper exercise of the delegated functions.

Sections 5-9 of the Act, inter alia, includes provisions such as: (i) certification by each AO of correctness of accounts and propriety of charges; (ii) obligation of AOs to keep books and records and prepare accounts; (iii) procedures for opening bank accounts; and (iv) conditions for bank overdraft facility—that no bank should permit an overdraft on any account unless authorized in writing by the PS-MFNP.

However, the Act gives some flexibility and authority to the PS-MFNP. For examples: (i) when deemed necessary, the PS-MFNP can establish funds and working accounts for different purposes; (ii) the PS-MFNP may authorize the issue, from general revenues, of sums which may be used to meet payments due for public services which, for reasons the PS-MFNP deems sufficient, cannot presently be charged to any vote, and to make provision for any payment which has been made under any head of expenditure and which has been disallowed as a charge against the head of expenditure in the approved estimates; and (iii) the PS-MFNP may authorize that the outstanding balance of any advance account be charged to appropriate expenditure. The Finance Act also makes a very brief reference to the role of internal audit, without defining it.

The Public Audit Act of 1980. The Public Audit Act contains provisions similar to those in the Constitution with respect to the AG. It spells out clearly the AG’s roles, responsibilities, and reporting obligations. It is noteworthy that the 1980 Act essentially gives the AG the authority to follow public money to anywhere it may go. It widens the power of the AG beyond the audit of books, records, and reports of Government departments and the statutory corporations described in the Finance (Control and Management) Act to include the audit, as she/he deems fit, of every statutory corporation and every private institution that receives Government grant, subsidy, or subvention in any financial year. The AG is empowered to request from independent auditors of state-owned enterprises (SOEs) any document, reports, or information relating to the accounts of SOEs. Also, every contract involving the Government or its agencies and enterprises was to include a clause allowing the AG to have access and examine all books relating to the contract. It also provides for the hiring of agents or specialist consultants by the Minister of Finance, at the request of the AG, to assist the AG in the performance of her/his duties.

Financial Regulations. The Finance Act is complemented by a subsidiary legislation, cap. 600 entitled "Financial Regulations," which contains general financial rules and procedures, some Ministry of Finance/Treasury regulations (1985) and circulars, the accounting guides of 1992 (financed by ODA), and other procedures and instructions such as stores regulations of 1969. Internal audit function is explained in the financial regulations (cap. 600).

Improvements Needed in the Legal Framework

While the legislation governing public finances is reasonably comprehensive in nature, it gives flexibilities to the Minister of Finance and the Permanent Secretary of MFNP that could be easily misused in the absence of a proper Parliamentary oversight. In fact, the experience over the past decade has shown that this has proven true. The PEMFAR is not intended to represent an exhaustive review of the legal framework, but instead it highlights major issues that should by considered carefully in the context of the overall constitutional review that the nation has begun to undertake. The review should address inconsistencies and also consider which financial provisions are best suited for the Constitution and which may be more appropriate in the Finance Act. Likewise, the Financial Regulations will need to be brought up to date to be consistent with a new Constitution and Finance Act.

Submission of the Budget Estimates to Parliament. The Constitution permits the Executive to wait three months into the new fiscal year before tabling the budget in the National Assembly (article 117(1)). This essentially obliges the Parliament to approve a quarter of the year's spending retroactively. Under the current practice, the Government actually tables the budget earlier—on the last Friday of January. This more closely parallels the provision found in the 1964 (Independence) Constitution, which gives one month into the fiscal year for tabling of estimates. However, even with only one month delay, Parliament still requires some time to debate the budget and vote on it; typically this process is not completed until late March, or three months into the budget year. The Constitution permits the Government to continue spending for up to four months while the budget is being considered. Nevertheless, the delay undermines democratic accountability and impedes many ministries from fully undertaking activities they have planned for the year.

OECD (2001) has proposed what they consider best practice in this area:

> The government's draft budget should be submitted to Parliament far enough in advance to allow Parliament to review it properly. The budget should be approved by Parliament prior to the start of the fiscal year.

Countries may vary on exactly when the budget must be presented and how much time Parliament should be given. At a minimum, the budget should be submitted prior to the start of the fiscal year. In the cases of Malawi and Kenya, the Constitution specifies that the budget must be laid before the legislature before the new fiscal year begins. Yet, it would be preferable for Parliament to be given *at least two months* to review it before the start of the year.[15]

Authority to Spend when the Budget is Delayed. Article 115(2)b of the Constitution permits the President to authorize a provisional warrant to permit spending for up to four months if the budget has not yet been enacted. While it is prudent to make provision for

15. The precise date can be specified as part of the overall budget preparation calendar in the Finance Act or the Financial Regulations. A fuller discussion on the presentation of the budget is found in chapter 4.

continuing government services in case of a delayed budget, countries usually set limits in the law to prevent spending from exceeding the prior year's approved budget. In Zambia, the Constitution is silent on this issue—implying that Government is not necessarily constrained. Although paragraph 11 of the Financial Regulations do have a provision that appears to limit spending, the fact that it is only an administrative rule means that the Minister of Finance could choose to change it at any time. A clearer provision that sets monthly limits based on the previous year should be established in law.

Supplementary Estimates. Once the budget is enacted, the Executive in most countries has the authority to execute the budget without interference from Parliament. Yet, this does not mean that Parliament has no role to play. Parliament has a responsibility to monitor the Executive's execution of the budget. Where the Executive requires changes, they are typically to be approved by Parliament through a supplementary appropriations bill. When such changes to the budget can be made without the prior consent of Parliament, it de-legitimizes the Parliament's role in the budget process altogether.

Zambia's constitutional provisions for Supplementary Estimates are extremely lax—instead of encouraging democratic accountability, they undermine it. Article 117(4) essentially gives the Executive a free-hand to modify the appropriations act any way it sees fit, so long as a report is eventually tabled before Parliament. Specifically, it states the Minister of Finance has up to 15 months after the end of the fiscal year to table a supplementary appropriations bill. Thus, it is nothing more than a confirmation of the spending which has already occurred. There are apparent inconsistencies in the legislative framework as well, which suggests that stricter terms may have been considered at one time. For example, article 115(2)c of the Constitution could be interpreted to mean that approval of supplementary estimates by Parliament was to proceed the issuing of the warrant by the President. Likewise, paragraph 17 of the Financial Regulations asserts that supplementary provisions were to be approved by the National Assembly before a warrant is signed by the President and before the Permanent Secretary issues Treasury Authority to the controlling officer.

In practice, the Executive has been submitting its supplementary appropriations bill at the end of the fiscal year, and its content is incorporated into the following year's budget document (the Yellow Book). However, the point remains that the spending occurs prior to Parliament's intervention into the process. It is only after the fact that Parliament gets involved formally. Perhaps not surprisingly, this has lead to a situation where supplementary appropriations are frequent and large—amounts sometimes surpassing even the original budget estimate. Table 8 provides some examples from the Year 2000 budget. While any specific example may have some explanation behind it (an emergency of one kind or another), taken as a whole they show a pattern of failed budgeting. In some cases, even with a supplementary estimate the actual expenditures appear to exceed the authorized level. Thus, the budget that is implemented by the Executive deviates significantly from that which Parliament authorized.

To improve accountability, the financial provisions in the Constitution should be amended to require that as a general rule, supplementary estimates be presented to Parliament for approval before the expenditures have occurred.[16]

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16. Currently, the provisions in the Financial Regulations appear stricter on supplementary appropriations than the law, but this still leaves a potential risk to the accountability framework because the regulations can be more easily changed.

Table 8. Illustrative Examples of Use of Supplementary Appropriations (Year 2000 budget) (millions of Kwacha)

			Initial Budget	Supple-ment	Revised Budget	Supple-ment as % of Budget	Actual Expenditure
Home Affairs	Pes	HQ	425	697	1,122	164	1,884
	RDCs	Immigration	942	1,075	2,017	114	1,147
		Nat'l Registration	398	5,507	5,905	1384	1,865
Defense	RDC	HQ	618	2,412	3,030	390	3,054
		Air Force	1,941	24,295	26,236	1242	46,423
		Nat'l Service	2,793	0	2,793	n/a	13,814
		Intelligence	183	1,176	1,359	643	1,498
Foreign Affairs	RDCs	HQ	2,228	4,842	7,070	217	5,511
Finance	RDCs	ERM	115	186	301	162	219
Labor	RDCs	HQ	207	858	1,065	414	802

Source: GRZ, Annual Budget ("Yellow Book") and Financial Reports.

Authority for Emergency Spending. Article 115(2)d provides for the President to issue a warrant authorizing expenditure from the general revenues in cases where "no provision exists for the expenditure and the President considers that there is such an urgent need to incur the expenditure that it would not be in the public interest to delay the authorization of the expenditure until such times as a supplementary estimate can be laid before and approved by the National Assembly." This provision responds to a legitimate need for the Executive to have the authority to deal with national emergencies as they arise and without having to convene Parliament. The problem is that this can easily be abused. Perhaps to mitigate this risk, the Zambian Constitution permits Parliament to prescribe other conditions and limitations (article 115(4)), and it also requires a supplementary estimate to be laid before Parliament within four months (article 116).

In contrast, neighboring countries have dealt with emergency spending through a voted Contingency Fund. For example, article 180 of Malawi's Constitution states: "The National Assembly may make provision for the establishment of a Contingencies Fund and for authorizing the Minister responsible for Finance, if he is satisfied that there has arisen an urgent and unforeseen need for expenditure for which no other provision exists, to make advances from that Fund to meet that need . . ." Kenya's Constitution Art 102 has identical wording. Both go on to say: "Where an advance is made from the Contingencies Fund, a supplementary Appropriation Bill shall be introduced as soon as possible for the purpose of replacing the amount so advanced." The South African Finance Act requires that the amount used for emergency expenditures be reported to Parliament and the Auditor General within 14 days, and that a supplementary or "adjustments" budget be submitted to the National Assembly within four months at the latest.

Authority for Unauthorized Expenditure. It is common for finance laws to contain some provision for accommodating spending that occurs in excess of the appropriation and without the authorization of Ministry of Finance.[17] In such cases, Ministry of Finance is assumed to take disciplinary action against the responsible officers for the improper expenditure. Yet, because the State may have had the obligation to liquidate the liability to the supplier, Parliament is asked to approve the expenditure retroactively (which it has the right to refuse). Article 117(5) of the Zambian Constitution contains provisions for this: "Where, in any financial year, expenditure has been incurred without the authorization of Parliament, the Minister responsible for finance shall, on approval of such expenditure by the appropriate committee of the National Assembly, introduce in the National Assembly, not later than thirty months after the end of that financial year . . . a Bill to be known as the Excess Expenditure Appropriation Bill for the approval by Parliament of such expenditure." Some delay is to be expected for Ministry of Finance and/or the Auditor General to discover the unauthorized expenditure, however, the time period specified in the current article of the Constitution is excessively long. The provision should be revised to include a much shorter time period—consistent with the tabling of the audited financial statements. The second concern is that the provision as written could be abused by a Ministry of Finance purposely to carryout expenditures which were not foreseen by the budget. Provisions such as this one are only viable with an effective system of oversight that can deter abuse. The South African Finance Act specifies that Parliament can reject the unauthorized expenditure, in which case "that amount becomes a charge against the funds allocated for the following or future financial years under the relevant vote." Still, the unauthorized spending should be followed by sanctions by the Ministry of Finance against those involved.

Virements. The Executive can make some changes to individual line items without recourse to Parliament. The rules on transfers or virements contained in paragraph 16 of the Financial Regulations of Zambia seem reasonable and consistent with those of other countries: "If the excess expenditure on one item can be met from savings on another item within the same sub-head on another sub-head, not being a sub-head for 'personal emoluments,' an application for Treasury Authority will be submitted for approval to the Permanent Secretary." Under these conditions no consent from Parliament is required. The South African Public Finance Management Act (1999) has a similar provision but goes a step further by placing a limit of eight per cent on the amount of transfer that can occur between main divisions within a vote (article 43).

Deadline for Financial Statements. A key instrument in Parliament's oversight of the budget is the annual Financial Report of the Government. Article 118 of the Constitution expressly requires the Minister of Finance to table before Parliament the Financial Report within nine months of the end of the year. Often Government has been late in submitting the report, but in the past couple of years this has improved. Still, the nine month delay is too long to promote accountability. The financial report should be presented within six months after the end of the fiscal year, and the Auditor General's report within nine months. In this way, they can both be inputs into the following year's budget debate.

17. Kenya provides for a "statement of excess" and Malawi provides for a supplementary if it is found that "any moneys have been expended for any purpose in excess of the amount (if any) appropriated for that purpose by the Appropriation Act."

Summary of Recommendations concerning the Legal Framework:

(a) The proposed budget should be submitted to Parliament with sufficient time for them to review and enact it prior to the start of the fiscal year. See more discussion of budget presentation in Chapter 4.
(b Limits should be fixed in law on the amount of spending that can occur before the budget has been enacted, based on the previous year's approved estimates.
(c) Supplementary estimates should require Parliamentary approval before the spending occurs.
(d) Emergency or urgent expenditures should be funded through a voted Contingency Fund, followed by a supplementary appropriation bill within a short time frame after the spending has occurred.
(e) The time period for submitting an excess expenditure bill to Parliament for unauthorized expenditures should be significantly reduced, and should be accompanied by disciplinary action by Ministry of Finance against the responsible officers.
(f) Annual financial statements of the Government should be submitted to Parliament within 6 months after the end of the fiscal year, and the Auditor General's report within 9 months.

Enhancing the Oversight Role of Parliament

In the preceding section, it was emphasized that Parliament needs to have the legal authority necessary to provide oversight of public financial management. This section considers other factors that will have a strong bearing on Parliament's ability to carry out its functions. These include technical expertise, financial resource, and the quality of information it receives from the Executive.

A Transparent and Complete Budget Presentation. Parliament's capacity to review the budget depends to some degree on the quality of the information provided. The structure or format of the budget should communicate the policy priorities of the government in a way that is clear and comprehensive. By comprehensive one means that it should include all government revenue sources as well as all expenditures. In Zambia, budgets have traditionally presented a misleading picture of the Government's quasi-fiscal position because critical information has been excluded. For example, Parliament lacks information about potential loans and loan guarantees that may obligate the government. (A fuller discussion of budget comprehensiveness is found in chapter 4.)

Other elements that help facilitate the readability of the budget documents include the budget classification system, the availability of comparative data on actual expenditure (from the prior periods), and information regarding the underlying assumptions. The current document provides little information with which Parliament can compare the estimates with actual spending trends. Nor does the classification system provide a clear picture of the functional or programmatic priorities of the Government. In fact, in many ways the classification is internally inconsistent. In practice, Parliament has had virtually no input into the presentation of the budget, and is challenged to analyze whatever they receive from the Executive in hardcopy. A certain degree of analytical time is lost to the task of extracting the right information from the budget document. Chapter 4 discusses in greater detail how the budget presentation might be improved.

Adequate staffing for budget analysis. Professional staff are essential for members of Parliament to be able to analyze the Government's budget thoroughly. The Budget Estimates Committee of Parliament was only formed about two years ago and still lacks adequate technical staff. Lack of resources contributes to the problem. Some degree of autonomy is also warranted to assure that pay scales and conditions of service are sufficient to attract the right staff. Ultimately, staff of the Parliament should be accountable to the Parliament and not to the Executive.

Greater influence on the content and direction of the budget. The Institute for Democracy in South Africa (IDASA) has identified three categories that explain the authority of Parliaments to amend the budget that is presented for vote.[18] (See Annex C-1 for models used in Western Europe.) On one end are the "unrestricted" powers, more commonly associated with presidential systems such as the United States, where the Legislature can increase or decrease expenditures or revenues without permission from Government. On the other end are groups of countries associated with the Westminster tradition that apply a "reductions only" approach. Under this tradition, Parliament may only reduce expenditure items, but may not propose additional spending. In some such countries, if Parliament were to pass an amended version of the Government's budget it would be comparable to a vote of no confidence.[19] This is closest to the tradition in Zambia. A third approach, in between these two extremes is whereby countries charge Parliament with responsibility to maintain the "budget balance" between revenues and expenditures proposed by the Executive. The Fifth Republic of France is cited by IDASA as having played a large role in promoting this model.[20]

In Zambia, Parliament is only permitted to propose savings and cannot propose additional spending for a particular head.[21] Because the budget is voted by head, one practical implication is that Parliament is not able to make broad functional reallocations within the overall envelope. Instead, its focus is on the allocations within each head. Moreover, since the budget does not generally contain programmatic information, the quality of the debate about the estimates is naturally going to be limited.

Going forward, Parliament should assert its existing powers to demand that Government estimates are well presented.[22] Furthermore, Parliament should be given an opportunity to

18. "Parliament and the Power of the Purse: The Nigerian Constitution in Comparative Perspective," revised version of a paper by Joachim Wehner (Budget Information Service, Institute for Democracy in South Africa), first published in the *Journal of African Law,* Vol. 46, No.2 (2002), pp. 216–231. Also drawn from an unpublished paper by the same author on "Executive-Legislative Relations in Afghanistan: Considerations in the Design of a Fiscal Constitution." (2003).

19. Ibid. Citing documents from the Inter Parliamentary Union, Wehner notes that the reductions only tradition grew out of the days when the House of Commons was called upon to consider demands for subsidies made by the Crown. The role of the Commons was to decide whether to comply, and if so, to what extent and by what means.

20. Article 40 of the Constitution of the Republic of France, 1958, cited in Wehner (2002).

21. The Parliament, of course, has the power to authorize additional spending by approving supplemental appropriations.

22. Some initial steps in that direction may have already been taken. In 2002 Parliament unexpectedly reduced the excise duty of diesel fuel, which compelled the Executive to make other changes in the budget.

provide input into the budget process before the budget is presented in detail in the Yellow Book. In chapter 4, sections D and E of this report, we propose that discussions with Parliament begin earlier over the medium term macroeconomic framework and the broad functional allocations that can be expected from the Government's budget.

External financing is an important part of the Zambian budget. Often these international agreements are not presented to Parliament concurrently with the budget proposal. Yet, because these agreements may have binding consequences on both the present and future Governments, their acceptance should not depend upon the Ministry of Finance alone. Rather, they should be submitted to the entire Cabinet, and ultimately to Parliament for approval.

Effective Monitoring of Budget Execution. Parliament's role is not limited merely to authorizing the initial budget; it needs to be able to monitor the implementation of the budget as well. In other words, it should be receiving regular reports from the Executive showing the rate of execution for each of the votes during the year. This level of transparency in budget operations is essential for Parliament to effectively exercise its oversight role—especially when there may be large variations. Unfortunately in Zambia, the Executive's current ability to produce reliable and timely reports on actual expenditure by budget line item is extremely limited. Yet, this does not negate the importance of establishing this capacity if Zambia is going to build effective mechanisms of accountability. The OECD has made monthly reporting on expenditures an example of best practice for transparency in public finance. As an interim step in Zambia, the Executive might rely upon cash release reports to inform Parliament and to signal when the budget estimates may need to be adjusted. However, over the longer term the MFNP should develop regular reporting based on commitments and actual expenditures. The frequency and accuracy of the reporting may be limited initially, but the objective should be to begin the process and to make improvements over time.

A more effective Public Accounts Committee. As in most Commonwealth countries, the Public Accounts Committee of Parliament is primarily responsible for review of the Financial Report and the Audit Reports. In Zambia, the committee is comprised of nine members. In keeping with Commonwealth traditions, it is chaired by a member of the opposition, while the Minister of Finance is an ex-officio member. Though chairmanship by the opposition may help accountability, if membership is nevertheless dominated by the ruling party there is a risk that the audit reports will not get the attention they require. According to PAC, other issues undermining accountability include the unresponsiveness of the Executive to queries from the PAC, and the failure of the committee's recommendation to be binding on the Executive. Parliamentary reforms are already under way in Zambia, and the role and authorities of the PAC should be addressed directly through this process.

Summary of Recommendations concerning Parliamentary Oversight:

(a) The format of the budget should be improved so that it provides Parliament with greater information and in a more accessible format (See Chapter 4.)

(b) Parliament should assure funding for professional staff or consultants to support the Budget Estimates committee and the PAC in review of the budget. The funding should be tied to the program prepared by the committees and the related cash requirement.

(c) Parliament should be required to agree on the overall macroeconomic framework or parameters of the budget and the broad functional allocations before the budget proposal is tabled by the Executive.
(d) The Executive should make periodic reports available to Parliament on the execution of the budget during the year. Moreover, requests for any supplemental appropriations should be made before expenditure is incurred.
(e) Consistent with the overall Parliamentary reforms currently under way, there should be a mechanism developed for ensuring that government responds promptly to the recommendations of PAC.
(f) Government should continue its policy of investigating individuals who have been named in the Auditor General reports or PAC reports.

PART II

Public Expenditure Management and Financial Accountability

CHAPTER 4

Budget Preparation

Budget preparation includes a wide range of issues, including the credibility of the budget as an instrument to carry out government priorities, comprehensiveness of the budget, the classification system used to identify the priorities, and the relationship between the budget and the overall planning and policymaking process. While it is hard to separate issues of budget preparation from those of budget execution, this chapter focuses on the processes that affect strategic allocation of resources and ultimately the execution of the budget. The section provides an analysis of the major problems and a recommended course of action for the government to pursue for each of the identified problems.

Credibility of the Budget

The lack of effective and credible budget preparation is one of the most serious weaknesses in Zambian Public Expenditure Management (PEM), which had significant impact on the quality and efficiency of public sector services generally. For years now, the Zambian government has consistently approved budgets that are structurally overcommitted and that lack the resources to meet the on-going obligations of the government. The most obvious result has been that actual expenditures at the end of the year bear little relationship with the original budget estimates. While the Ministry of Finance assumes the lead role in preparing the budget, the failure to reconcile spending priorities before the start of the year is clearly a problem that transcends any single ministry within Government. Indeed, the decisions for restructuring and streamlining the priorities of the Government are not merely technical issues but political ones and can only be made at a political level. Rationalization of the budget and the development of realistic budgets—given the resources that are expected to be available—must be a first priority of the government.

Analysis of the Problem

Developing a credible budget has in recent years been a major priority of the Government. However, the rationalization of government services that may be needed to achieve this has not yet occurred. Instead, government budgets have largely reflected only incremental changes from the prior year, without tackling the kind of substantive policy decisions needed to bring costs in line with resources. Some government infrastructure and services that were possible during an era of high copper prices are simply unaffordable today. On an aggregate basis, the budget appears to be in balance—with sufficient revenues and financing to cover expenses. However, what is less visible are the imbalances that exist on a ministry-by-ministry level—that is, budgets for some ministry activities are insufficient to cover the actual costs, which means that other activities are overbudgeted relative to the aggregate financing available. Imbalances also exist between central and local government levels. Ministry of Finance officials readily acknowledge that some of the activities of government have essentially fixed costs associated with them, which have to be met in some form or another, whether the activities are fully funded in the budget document or not. (Examples of these include civil service salaries and benefits, foreign embassies, bursaries for current students, and meals for those in prison.) Ultimately, these activities may receive the funds they require through the process of supplemental budgets approved by Parliament. However, they can only do so by underfunding other activities that have been previously budgeted.

Consequently, most line ministries realize that the budget is not a reliable basis on which to plan activities since actual releases will vary substantially from the amounts indicated in the budget. Chapter 5 provides quantitative examples of how much budget execution varies from budget estimates. For some ministries, the expectation is that they will receive less than they have been allocated in the budget; while for others, they can be reasonably assured of being able to obtain more. A review of any year's Financial Statements will show that in many cases the excess spending is accompanied by a supplemental appropriation. However, frequently, the Financial Statements indicate that excess spending occurs without a supplemental appropriation, or for amounts beyond what the supplemental provided. Unfortunately, under these circumstances ministries may conclude that there is little incentive to put substantial effort into budget preparation.

As indicated above, a conscious under-budgeting during budget preparation is one of the primary causes behind the eventual variance between the budgeted and actual expenditure. There may be a combination of circumstances that contribute to the under-budgeting, including a lack of good cost data from line ministries. However, there are clearly cases where the under-funding of activities is or should be easily discernable to MFNP. Table 9 below examines the historical pattern of budget estimates and actual expenditures for a few selected line items. For any individual case, there may be a sound explanation for the budget allocation decision that was made. Yet, together they show a common pattern in which budget estimates are often not adjusted to reflect the higher level of spending that has occurred in past years. Although the budgets do increase somewhat, they often remain below the historical spending level. The confirmation that the relatively high spending was not an anomaly for just one year is seen in the fact that the actual expenditures remain at the same or at an increasing level.

Table 9. A Comparison of Historical Spending with Approved Budget Estimates for Selected Line Items (millions of Kwacha)

			1998 Budget	Actual	1999 budget	Actual	2000 Budget	Actual	2001 Budget
Home Affairs	RDCs	HQ	469	944	400	1,020	620	1,553	1,653
		Prisons	447	4,285	390	1,495	1,508	3,871	2,126
Defense	PEs	Army	24,970	30,396	26,259	30,697	28,098	44,579	40,320
Defense	RDCs	Army	3,078	19,373	4,360	30,989	3,935	42,369	4,569
		Air Force	2,468	8,584	2,063	27,602	1,941	46,423	3,889
		Nat'l Service	2,247	5,257	2,794	8,286	2,793	13,814	3,099
		Med Services	2,230	2,229	3,512	4,607	3,511	5,967	2,495
Foreign Affairs	RDCs	HQ	2,440	5,116	797	3,415	2,228	5,511	4,210
		Lubumbashi	47	276	75	205	57	107	58
		Washington	305	622	264	629	385	120	912
		Cairo	260	589	223	641	661	644	597
		Kinshasa	145	429	135	430	139	546	191
		AddisAbaba	302	566	237	725	804	1,110	829
		Abuja	160	608	124	474	168	360	358

Source: GRZ, Annual Budget ("Yellow Book"), Financial Reports.

Three examples from table 9 make this point about underbudgeting stand out clearly. First, for prisons, the spending on recurrent departmental charges (RDCs)[23] was about 4.3 billion Kwacha in 1998 compared to a budget of 469 million. Yet, each of the next two years budget estimates were only 390 million and 1,508 million. Secondly, for the Army RDC spending in 1998 was more than six times the original budget estimate (19.3 billion versus 3.1 billion). This level of spending continued to increase substantially in each of the next two years (to 31.0 and 42.4 billion). Still, the budget estimates even up through 2001 for Army RDCs were only a small fraction of the 1998 level actual spending. Third, RDCs budgeted for foreign missions tend to be lower than their historical cost. For example, with the Kinshasa mission, RDC spending in 1998 was about three times the budget estimate (429 million versus 145 million). During the next two years the spending remained steady or increased, but the budget for 2000 had actually declined slightly.

Although the MFNP obviously does not have available to it any audited data on expenditures for the current year when it begins preparing budgets for the next year, it does possess other kinds of information that can be informative about the projected level of expenditures. Some of this may come from the line ministries themselves, but the MFNP also has its data on cash releases made to the ministries for the first half of the year and it has some information on expenditures from the prior year. In the examples included in

23. Recurrent departmental charges are equivalent to operations and maintenance.

table 9, data for 1998 would have been a good indicator of spending levels in 2000. Unless the budget organizations are obliged to make policy or programmatic changes that can lower the cost structure of the activities, there may be little reason to believe that keeping budget estimates artificially low will necessarily lead to lower spending by them. Thus, the actual spending level would tend to be a better indicator of future costs than is relying upon the prior year's budget estimates. Although the budget reflects national policy priorities (and not merely prior spending), pre-existing commitments may bring with them a cost structure than cannot be changed immediately.

Even the information available on supplemental appropriations could provide a good indicator to MFNP of the potential discrepancies in their budget estimate. For example, in the 2001 Yellow Book,[24] an appropriation of 14.1 billion Kwacha is proposed for the two RDC codes covering "Road, Rail and Air Fares." This is despite the fact that the total authorized budget (including supplementals) for the prior year was 87.7 billion or over six times that amount. Similarly, in 2002, only 13.4 billion was appropriated, despite the fact that the final budget in 2001 was 63.5 billion (about five times higher). While it is not unusual to have some variation because of the element of unpredictability, the magnitude of the difference suggests a need for inquiry. Perhaps policies must be changed to enforce the lower budget or a higher number acknowledged.

Had MFNP actually raised its budget estimates for the line items above, it necessarily would have meant lowering the budget estimates for other entities and/or increasing the planned deficit. Although the potential reductions in budgets for such activities as rural development, clean water, and health may not have been popular, it could nevertheless achieve budgets that better reflect the actual pattern of spending. At the very least, this would have made the tradeoffs and policy choices of Government more apparent and perhaps speeded the process of restructuring government programs. The current practice of underbudgeting, however, gives a false impression of Government's overall policy priorities and objectives. In addition, it creates an environment conducive to the accumulation of arrears, as ministries seek to find alternative means to meet their public service commitments.

It is also become apparent in recent years that the Government's process of collective bargaining with the civil service unions contributes to inaccuracies in the budget. For example, the 2003 budget was tabled well before the Government had concluded its labor negotiations. Although MFNP had allocated a precise amount for 2003 salary awards, unions did not feel bound by this figure and held out for increases that may have exceeded it. This, in addition to awards granted by the Public Service Management Division to non-unionized workers, can easily force the wage bill to exceed the amounts previously budgeted. This suggests that the entire process of wage adjustments and union negotiations needs to be revisited. The amount of the salary awards for the coming budget year needs to be known more reliably when the budget is submitted to Parliament.

Future Action Plan

Going forward, the Government must give the utmost attention to encouraging a credible budget. This would include policy decisions by the Government that better align the bud-

24. The Yellow Book is the name given to the Government's annual budget document because of its yellow cover.

get estimates with the historic costs of the activities, or that make policy changes in the programs in order to reduce their costs and bring them in line with budget. This is not an exercise that can be undertaken by MFNP acting alone. Nor can many of them be made within the context of the annual budget process. Closing offices or embassies, changing policies on bursaries, or reducing the size of the civil service are not actions that could necessarily be implemented within a few months, but would require some multi-year planning to achieve efficiency. Policies decisions are made now, with the full implementation in a future year. An MTEF would be an excellent framework through which to debate and make these kinds of tradeoffs. However, the absence of a full MTEF need not preclude the government from using other means to begin making transparent policy tradeoffs and more clearly identifying costs in the budget.

Making budgetary tradeoffs is ultimately a political decision that requires a collaborative effort on the part of multiple institutions at the center of government policymaking. However, there are some technical preparations that MFNP can do that could assist policymakers in generating informed decisions. Indeed, MFNP has a responsibility to do so. Key components of MFNP's work should be to quantitatively assess the current variances between the budget estimate and the actual expenditure to understand where the biggest problems lay and to understand the underlying activities that drive the costs. The Bank and other donors can provide intermittent TA to assist MFNP if necessary. Ultimately, programmatic decisions have to be made as to how to curtail cost in line with available resources. Yet, as the government makes progress in budget preparation, they should also be able to quantitatively show that actual expenditures for a given line ministry are more closely aligned to the original budget estimates. This is obviously a shared responsibility of both MFNP and the line ministries. Outlined below are more details on a proposed action plan that the Government should consider adopting.

Possible Action Steps:

(a) Establish a baseline analysis by comparing the 2003 budget allocations with the actual expenditures for 2002.

(b) Identify the line ministries (and subunits) that have the largest variance between budget estimate and prior actual expenditure. (This should indicate potential areas of under-budgeting in 2003.)

(c) Develop a programmatic understanding of what have been the major cost drivers for each of the line ministries (and subunits) identified above.

(d) Develop a policymaking framework or action plan for reconciling the differences between costs and budget estimates. The Plan/Framework would clearly delineate the roles and responsibilities of various institutions including MFNP, Cabinet, State House, and Budget Committee. Plan should address issues such as:

  (i) How to establish a multi-year planning horizon within the context of an MTEF so that decisions can be made today that provide at least one full budget cycle for line ministries to implement.

  (ii) How will decisions be made about the appropriate ceilings for each line ministry, and whether those ceilings should cover current cost or require programmatic cutbacks.

(iii) How will follow-up be done with line ministries to ensure that programmatic changes needed to produce cost savings are indeed implemented during the coming budget year.
(iv) How will future budget execution in the context of an MTEF be monitored to ensure faithful budget implementation.

(e) Beginning with the budget for 2004, give line ministries ceilings that are based on a percentage of actual expenditure rather than the prior year budget. (Since 2003 expenditures are not known by the time ceilings need to be communicated, the ceilings could be based on either the 6-month cash releases or on the 2002 full-year expenditures or some combination of the two. Supplemental budgets are not fully available yet, and are only a partial proxy.)
(f) Require line ministries to submit budget requests for 2004 that conform with the ceilings that are communicated above, and reach agreement on the programmatic savings that are expected from them for the next year (2005).
(g) During 2004 verify that programmatic changes agreed to are being implemented by line ministries, and repeat actions above to identify new round of line ministries and/or activities to target.
(h) Review how collective bargaining with public service unions can be improved to assure that the amount of the salary award is known by the time the budget is presented to Parliament.
(i) Reduce the use of supplemental appropriations.

Comprehensiveness of the Budget

Lack of comprehensiveness of public expenditures and fragmentation of budget information are two major issues that contribute to undermining credibility of the budget in Zambia. A number of policies or actions initiated by government and its agencies generate indirect costs which are not explicitly recorded in the budget but ultimately have to be paid for by the government. These are often termed quasi-fiscal activities. A recent estimate for Zambia shows that the consolidated public sector deficit—consisting both of the non-financial public sector deficit (or government) and the quasi fiscal deficits of the central bank—is far higher than that of central government budget deficit alone (World Bank, 1998). Accounting for public sector's expenditures and deficits beyond those reflected in the current central government's budget becomes very critical to understanding the true fiscal position of the country. Without such comprehensive budget formulation, it will be difficult to have good budget management, policy analysis, and formulation.

Accounting for overall public sector expenditures and revenues is important for two main reasons. First, the size of the overall public sector deficit has consequences for macroeconomic stability. A common method for financing government deficit is to rely on the central bank to raise the reserve money, which without a corresponding increase in the demand for money, will amount to inflationary financing. In many countries including Zambia, this is often facilitated by the lack of independence between the central bank and the government. Second, from a fiscal policy standpoint, sustainability of the fiscal deficit depends not only on the deficit of the central government, but on the consolidated public sector deficit that includes the accounts of the Bank of Zambia, parastatals, pensions funds, and other public entities. In the case of Zambia, the importance of the latter in determining fiscal sustainability and solvency are thoroughly discussed and illustrated in World Bank (1998).

A consolidated and comprehensive public sector expenditures budget would need to go beyond the central government to include activities and expenditures of local governments, extra-budgetary funds, public enterprises, and the central bank. In addition, the budget would need to include other "off-balance sheet" items, such as guarantees and other contingent liabilities of the public sector as well as the fiscal risks associated with such items. The omission of these items may provide a misleading picture of the financial position of Zambia, especially due to the heavy losses and contingent liabilities coming from state enterprises and public sector pension funds.

Analysis of the Problem

Zambia's budget is confined to central government and lacks information on local government expenditures, state enterprises, pension funds, special funds, and quasi-fiscal activities of the Bank of Zambia. Each of these issues is briefly discussed below.

Quasi-fiscal deficits of the BoZ. The deficits of the BoZ mainly include losses on foreign exchange transactions, losses due to loans and guarantees to parastatals, and losses associated with failure of commercial banks. In principle, the BoZ is entitled to compensation from the treasury on all foreign exchange losses arising from its operation, as well as on losses on loans and guarantees to parastatals. In practice, these losses are not allowed for in the budget, although these losses have substantially been reduced in recent years.

Parastatals. Subsidies to and losses of state-owned enterprises are not reflected in the budget. With the significant progress made in the 1990s in privatizing most of the key parastatals, the Government has been able to avoid paying additional subsidies to these companies, which constitutes an important saving. However, there are still a few state enterprises (such as ZANACO, ZAMTEL, ZESCO, and INDENI/TAZAMA) whose activities and losses have important budgetary implications, which would need to be reflected in the budget to ensure comprehensiveness.

Pensions funds. The two most important pension schemes in Zambia are the Public Services Pensions Fund (PSPF) and the National Pension Scheme (NPS). The PSPF is a defined benefit scheme, funded by a 14.5 percent payroll tax split evenly between employees and the government. However, government has on several occasions failed to include its share of pensions contributions and obligations in the budget. Such obligations would need to be adequately reflected in the budget to ensure comprehensiveness.

Local governments. Information on local government accounts is not adequate in Zambia. Anecdotal evidence shows that revenues of sub-national governments are estimated to be extremely small as a proportion of total government revenue—about 4.6 percent in 1997, for example—and have been contracting in real terms for the last six years or so (Saasa et al. 1999). Transfers from the central government constitute only a negligible part of local governments' revenues as well—around 3 percent in 1997. There is a need to obtain adequate information on local government budget, and include it in the national budget to ensure comprehensiveness.

Contingent liabilities. Accounting for contingent liabilities is important because actual historical deficits represent too narrow a view of the public sector's exposure to fiscal risk.

While contingent liabilities are not directly associated with any existing budgetary program, a government's commitment to accept obligations contingent on future events amounts to a hidden subsidy and may result in a major unexpected drain on government finances in the future. Several expenditure items may need to be accounted for as "contingent" liabilities faced by the public sector. In the case of Zambia, the key items are likely to be: GRZ guarantees on public pension funds, GRZ guarantees on loans to public enterprises, and BoZ guarantees associated with parastatals/state-owned enterprises. The fiscal fragility of the public sector, as reflected by the unrealized but yet still potential loss in each period, has been growing up to 2000, in large part due to the delay in ZCCM's privatization. These contingent liabilities are expected to continue to diminish with phasing out of the GRZ "paper" notes issued to Bank of Zambia and the expected improvements in the implementation of the ongoing pensions reform.

In addition to the above, there are two other areas that may need emphasis. First, there is strong evidence suggesting that revenues from non-tax sources (in particular, fees for services) are substantially under-reported and generally withheld at the source rather than remitted to the government account at the BoZ. In addition, extra-budgetary funds, financed by non-central government grants, are not covered in the budget documents. Second, the budget is not comprehensive in terms of coverage of donor activities. Donors often execute their own projects in order to improve outcomes and avoid expenditure wastage and irregularities. However, to the extent that actual donor expenditures are not reported and differ from plans, the full coverage of public expenditure is not known. The inputs of donor resources into a particular sector may also create imbalances in the distribution of resources across provinces if not coordinated well with Government. (See discussion in Chapter 9 on the Educational Service Delivery Survey.)

Actions Taken to Date

In Zambia, until recently, the domestic and external budgets were not integrated well institutionally. The Director of Budget in the MFNP concerned himself with domestic revenues and domestic expenditures, while the external resource mobilization department of the MFNP and the BoZ monitored balance of payments (BoP) inflows and used them to pay external debt service directly. If there were a shortfall in BoP support, the BoZ would cover the debt service requirements with its reserves and increase the balance of the "forex bridge loan" from BoZ to the government correspondingly. Similarly, if there were an excess of BoP support, it would be used to reduce the balance of the forex bridge loan. Domestic debt was recorded by the Bank of Zambia, which reported to the MFNP, but MFNP did not have its own database of domestic debt with which to monitor the overall exposure as well as integrate domestic and external debt management.

However, under the support of Bank's Fiscal Sustainability Credit 1 (FSC1) of 2000, the government was able to improve the database and management of domestic and external debt. In particular, FSC1 helped the BoZ and the MFNP to adopt a computer based data system for recording and managing domestic and external debt in an integrated manner. In addition, the agreement under the Credit that the BoZ should be compensated by the government for all losses on new guarantees helped control the quasi-fiscal deficit of BoZ arising from such activities. The BoZ has not been called on to provide any guarantees in the last two years.

Future Action Plan

A number of actions are needed to address problems surrounding the lack of budget comprehensiveness:

- Enforce the estimating and reporting on the quasi-fiscal deficits of the public sector, including deficits of the BoZ, pension funds, and state owned enterprises, as part of the annual budget presentation to Parliament.
- Integrate information on major contingent liabilities of the Government into the budget.
- Make a steady effort in collecting regular information on local government revenues and expenditures, and in integrating such information in the budget.
- Enforce regulations/controls on reporting of all government receipts including fee income generated by line ministries.
- Establish a system to improve coverage of donor-executed projects and expenditures in the budget.

Budget Classification

Because the budget structure is limited to an administrative and very broad economic classification, it often obscures the major activities and programs being carried out by Government within and across sectors. In response, the MFNP has worked over the past several years to develop the concept of Activity Based Budgeting (ABB). ABB is intended to provide a detailed functional classification as the basis for budget management, and thereby improve the link between resource inputs and specific activities or outputs. Considerable work remains, given that ABB has thus far only been piloted in a few ministries and it is not yet integrated into the cash release system and accounting system. Until this occurs, ABB is unlikely to have a substantial impact on the budget process. Realistically, it is difficult to see how ABB will be implemented meaningfully until the information systems are upgraded, thereby enabling the accounting system to accommodate it. In the meantime, more could be done to reinforce compliance with existing budget rules, including the proper classification of expenditures in the budget. The misclassification of expenditures across budget headings and economic classifications is not uncommon and serves to obscure the real nature or intent of public expenditures.

Analysis of the Problem

The current budget structure lacks a functional or programmatic classification that would allow one to understand the policy priorities of the government. While some of the administrative headings, especially in education, do allow one to discern the functional purpose of the expenditures, by and large the current administrative classification is not a substitute for a functional or programmatic classification of the budget. Because of this, it is difficult to identify what are the poverty-reducing expenditures in the budget, except in very broad aggregate terms. While the ministries that participate in poverty-reducing expenditures are known, the activities for which they are responsible are often obscured in the current administrative classification. Even if budgets are initially prepared within the line ministry in a more detailed manner, these are not carried through in the cash release process or in the accounting for expenditures. (For example, MOE has prepared detailed estimates of the cost of running a school based on various characteristics of the school, but the accounting system does not permit them to track the actual cost.) It is in part for this reason that the HIPC process necessitated that the Government adopt a parallel system that preserved some of this additional information in outturn reporting. Without this, it is only by classifying an activity as a "project" that one is able to directly monitor spending on it. The tradeoff is that one loses the detail on the economic nature of the spending, for example, whether for salaries or supplies.

The economic classification currently in use obscures in many ways the true nature of expenditures and is largely inconsistent with GFS standards. The Zambian budget groups expenditures into four broad categories—Personal Emoluments (PEs), Recurrent Departmental Charges (RDCs), Grants, and Capital Expenditures. Under each of these are more detailed categories: some of which are displayed in the budget and others that were used only for initial budget preparation and internal use. Yet, the inconsistencies in the budget classification quickly become apparent. Capital expenditures, for example, may consist of "movable objects" or "projects," the latter of which may or may not include capital assets. Many of the "projects" are recurrent in nature, and may be categorized there because of the element of donor funding.

Likewise, the category "Grants" includes payments for salaries and for operational expenses. In some cases, salaries and wages are very deliberately budgeted for under the grants heading in order to reduce the amount shown to be budgeted for PEs. During the research for the PER, staff from the Ministry of Health were candid in explaining the incentive to do this for the 1997 budget (to respond to donor pressure). This type of reclassification of personnel costs as grants was still evident in the 1999 budget. A review of the 1999 Financial Statements (Table 10) shows that the budget for the Ministry of Health called for PEs of 5.6 billion Kwacha (at headquarters) and Grants of 44.4 billion Kwacha (for provinces), but the report on actual expenditures suggested that the grants were once again intended for salary payments. The financial statements prepared by the Auditor General show expenditures on grants as only 10.8 billion Kwacha (or one-fourth the budget), but the amount spent on PEs is 38.6 billion Kwacha (almost seven times the budget). When the PE and grant amounts are taken together, there is little difference between budget and actual expenditures, it is only the relative proportions between the two that have changed.

Table 10. Ministry of Health (billions of Kwacha): Budget Line Items Through Which Personnel Costs are Paid

	1999		1998	
	Budget	**Actual**	**Budget**	**Actual**
PEs—Headquarters	5.6	38.6	2.2	16.4
Grants—Provinces	44.4	10.8	37.5	19.3

Source: GRZ, *Financial Report, 2000.*

Complicating matters further, personnel-related costs also appear hidden within the allocations for RDCs. One of the major subcomponents of RDCs is "allowances." Though the RDC category is generally the equivalent of "operations and maintenance" (O&M) in other countries, in Zambia RDCs include employee allowances for subsistence, mileage, and meals.[25] In the 2001 budget, allowances were set at 33.4 billion Kwacha, which is equivalent to about 5 percent of the budgeted PEs and about 5 percent of the total RDCs. Though this may seem relatively small, in actual practice it may be considerably higher. The structure of the Financial Report does not permit one to see the aggregate expenditures for this economic classification as a whole, but it does show the wide variance at some institutions. For example, allowances paid by the Office of the Vice-President, Parliamentary Business were 4.95 billion Kwacha compared to a budget of 4.1 million. The Judiciary-Industrial Relations Court allowances were budgeted at 6.9 million but actual spending was 66.1 million. (Though this looks like a relatively small variance compared to that for the Office of the Vice-President, the difference is nevertheless a magnitude of 10, and there are other examples in that range.) The overall point is that the budget classification as it is structured and applied in Zambia makes it extremely difficult to determine the true level of personnel versus non-personnel related expenditures. The system, therefore, is in need of substantial reform.

Actions Taken to Date

Recognizing the limitations of the current budget classification, MFNP has had a team working on the development of ABB with assistance from the EU. The ABB aims to provide functional, economic, administrative, and spatial (or geographic) classifications of the budget. Although earlier versions of the ABB classification appeared to be incompatible with GFS, those issues have been resolved and the latest proposal is generally consistent with GFS.

ABB is being piloted in several ministries now.[26] However, it has not yet been incorporated into the mainstream of public expenditure management. Thus far, ABB has primarily been a budget preparation tool used within line ministries. Although there has been discussion about the need to integrate it with the accounting system, one of the obstacles to this occurring has been the outdated computer system and software currently used by the Accountant General's office. The system is not conducive to making the kinds of major overhauls that are required for ABB. Similarly, the ABB classifications are not used to determine the cash releases to line ministries. In summary, it means that even if line ministries use ABB to prepare their budgets, the budget approved by Parliament is not in that format, nor are the cash releases they receive, or the outturn reports required by the Accountant General. Indeed, as long as ABB is a parallel system for budget preparation it will be of marginal value to the ministries.

25. RDCs also include training expenses, which in practice is possibly being used to supplement wages to some degree as well.

26. The budgets for four ministries (Local Government and Housing; Commerce, Trade and Industry; Works and Supply; and Land) were developed in 2000 using ABB for application in 2001. This pilot test was extended to an additional six governmental units (Office of the Vice President; Public Service Management Division; Cabinet Office; Environment and Natural Resources; Agriculture, Food, and Fisheries; and Science, Technology, and Vocational Training) in 2001 for application in 2002.

Once ABB is integrated into the internal control and accounting structures it could potentially be very helpful to improving the transparency of the budget by highlighting specific activities or functions being carried out, including identification of poverty-reducing spending.[27]

Future Action Plan

Going forward, MFNP should take immediate steps to reduce the more blatant cases of misclassification of expenditures that occur under the existing system. In other words, for the sake of transparency, PEs need to be budgeted under PEs and not under other economic classifications. Over the medium term, MFNP should be taking actions to expand the use of ABB by line ministries and to integrate it with other parts of the budget process and reporting. Although full implementation of ABB may hinge upon implementation of IFMIS, there are transitional steps that MFNP can begin taking as preparation.

Possible Action Steps (short term):

(a) Ensure that expenditures in the next budget are categorized correctly under the current economic classification system. In particular, ensure that payments for personal emoluments to civil servants are not hidden in other categories such as grants.
(b) Make the integration of ABB a more explicit part of the planning for IFMIS. This includes addressing specific concerns that the Accountant General may have with the structure and ensuring that all coding needed for accounting purposes are taken into consideration.
(c) Begin planning how (domestic) capital expenditures will be better integrated with the recurrent budget; in particular, how to ensure that it uses the same classification structure.
(d) Begin developing a crosswalk between the ABB and existing budget classification, and then generate supplemental expenditure reports that can be compared with the initial ABB budgets.

Possible Action Steps (medium term):

(e) Use ABB coding in the pilot rollout of the IFMIS.
(f) Inform Parliament of the presentation of the budget in ABB format.
(g) Ensure that cash releases, commitments, and expenditure accounting all use the same classification—rooted in ABB. (Some differences in the level of aggregation may be appropriate however.)
(h) After ABB in pilot ministries has been expanded to budget releases and accounting, then expand ABB in budget preparation to all ministries.

27. There has been some concern expressed that the potentially 32-digit coding structure could be more complicated than is necessary or practical. However, even if there is scope to make modifications in the ABB, it is already a credible foundation on which to begin building the account coding.

Links Between Budgeting and Planning

Given the difficulties that Zambia has had with executing the annual budget, integrating a medium term expenditure framework could pose some challenge. Indeed, some aspects of an MTEF would be difficult to implement credibly until there is greater consistency between the annual budget and the actual expenditures for the year. Yet there are parts of the process of developing an MTEF that could be critical to helping the GRZ to develop more credible budgets and to making the prerequisite downsizing of the public service structure. The MTEF is obviously no panacea for improving the quality of budget preparation. However, it is a tool that could serve to reinforce the importance of other reforms that are taking place. This section examines the linkages between planning and budgeting and outlines some incremental steps that could over time lay a foundation for better budget planning and implementation.

Analysis of the Problem

The relationship between planning and budgeting in Zambia can be viewed from several perspectives. With each aspect there is a substantive impact on the quality and credibility of budget preparation.

Disconnect between medium term development objectives and the annual budget process. One of MFNP's own critics of the PRSP has been that it lacks a medium term fiscal framework. Without the link to budgetary constraints, the PRSP becomes little more than a wish list. Although some prioritization is already reflected in the PRSP process, it is hard to judge whether it is sufficient without greater insights into the prospective funding envelop either on an aggregate basis or by major sector.

A consultant's January 2002 draft "Zambia PRSP: Resource Envelope, Sectoral Priorities, Financial Costs and Programming," was a first step taken by the government to compare the expected cost of the PRSP activities with the expected resources. Considerable work remains, however, if this initial analysis is to be mainstreamed into the budget process. A couple limitations of the exercise are that (i) it focused exclusively on the development budget and not the entire budget, and (ii) it was a stand-alone exercise and was not directly linked to the annual budget process.

New initiatives are not adequately costed. As new policies and programs are being developed, decision-makers should be aware of the likely budgetary impact and consider it in their deliberations. However, there has been little evidence in the past few years that policy formulation in Zambia is closely linked to budget preparation. On the contrary, it appears that many new government activities are initiated without an adequate and comprehensive costing, and more importantly, without an explicit indication of where the off-setting resources would come from. It is well known that the budget is fully committed at the start of the budget cycle, in effect, that there are no additional funds for new initiatives. Yet, the institutions that are at the center of policy formulation are not necessarily obligated to consider the cost of the activity or to propose off-setting savings in order to accommodate it.

Prior to the start of the budget year, there needs to be a means to translate the broad policy statements of the Government into budget terms. For example, do the priorities outlined in the annual budget speech really translate into concrete programs and activities that have discrete costs associated with them—both in the budget year and beyond? The relative roles of Cabinet Office and MFNP in costing the Government's programs have traditionally been undefined, and often this activity does not occur. Although additional resources may be added to a ministries budget, there has not been a clear link to specific activities or policies. One example cited by the IMF in its June 2000 report was the 1999 international conference in Lusaka on AIDS, which although planned in advance, was not explicitly budgeted for. In 2001, the same can probably be noted of the OAU conference hosted in Lusaka, which required substantial outlays in excess of the initial budget.

Too short of a planning horizon to implement some policy changes that require phasing. Because the annual budget is structurally imbalanced, it will require the Government to make hard choices to curtail some public sector activities. Yet for some activities, programmatic changes needed to reduce the cost structure may not be easily implementable within a single year—even less so within the weeks between the presentation of the budget to Parliament and its approval by Parliament. Some decisions such as closing embassies, changing benefits to university students, hospital reimbursements, or the size of the payroll may require some lead time to be introduced. Ministries cannot wait until the approval of the budget to begin implementing them for that same year. MFNP therefore needs to have a longer budget horizon to offer line ministries in order to assure that programmatic changes are implemented.

Not only in cases of downsizing, but also in the initiation of new programs or new capital projects, a longer planning horizon is needed. Before a new program or project is funded initially, MFNP should be compelled to show how the program/project will develop over time and its implications for the budget. This is particularly crucial for capital projects, when multi-year funding is necessary in order to complete the project and to produce a usable asset. For example, a half-completed road or bridge would make a second year of funding essentially an obligation, and therefore it should be factored into decision making for the sake of transparency and for economically justifiable decisions. The recurrent costs of the projects once they are completed could also be more easily captured with a multi-year framework in place.

Lack of a medium term budget horizon and budget priorities inhibits effective dialogue between Government, Parliament, civil society, and donors about the broad policy direction being pursued. Experience in South Africa has shown that their Medium Term Budget Policy Statement (MTBPS) has increased transparency of the budget process and improved discussion with Parliament as well as civil society about public spending priorities. The MTBPS has been useful because it is formally debated by Parliament, and because its aggregated format focuses the discussion at a more strategic level, before detailed line items are ever presented. In contrast in Zambia, the presentation of the full budget, in all its detail, to the full plenary of Parliament and only after the beginning of the budget year, is not a process that is conducive to strategic deliberations. To promote greater accountability and transparency for the budget, MFNP would benefit from presenting to Parliament an updated MTEF prior to the development of the Yellow Book estimates. This shorter, more strategic-level policy document could help focus discussion about relative functional priorities in a way that the current process does not.

Likewise, a medium term budget horizon would facilitate the Government's dialogue with cooperating partners and help to assure better congruence with national development objectives. As has been seen in Tanzania and Uganda, an MTEF that is comprehensive in its coverage of the budget provides a logical framework for dialogue between the government and its cooperating partners over spending priorities. Too frequently, GRZ is in a position in which it is reacting to the funding proposals of cooperating partners. By focusing on the totality of the budget, the annual development/updating of the MTEF would put government in a position to initiate and guide the discussions around funding needs and donor commitments for each of the major sectors. Even if the estimations of cooperating partners for future funding are imprecise, it nevertheless puts government in the appropriate position of leading the discussions around funding priorities.

Actions Taken to Date

During the mid to late 1990's MFNP did produce an analytical document referred to as medium term fiscal framework (MTEF), however, it was never a very significant part of the budget process. The document appeared to be little more than an internal planning tool for MFNP to consider aggregate resource levels and broad functional allocations. There was no Parliamentary discussion of the document; nor was it binding on any agencies. The document was generated by MFNP and lacked bottom-up input from line ministries or donors.

Recent efforts to launch development of an MTEF have hinged upon a restructuring of MFNP and the creation of a Planning Unit. Restructuring was completed at the beginning of 2002 and the Director of Planning was appointed. Although a local consultant had been available to the MFNP Budget Office under FSC to assist with MTEF throughout 2001, the Ministry could not take full advantage at that time as the Department of Planning had not yet been established.

Subsequently, through FSC support, the government sent three teams of staff to review the work done on MTEF in South Africa, Uganda, and Tanzania. With that experience behind them, the MFNP Planning Department, developed a Budget Framework Paper (BFP) as a forerunner to the MTEF and as a guide to drafting the 2003 budget Call Circular and developing budget ceilings. The BFP is intended to provide Zambia's political leadership with a full picture of the financial liabilities, policy commitments, and program costs of the government, as well as the likely resource envelope. The BFP takes into account both domestic and non-project foreign financing expected in 2003. The process of developing an MTEF for 2004–2006 has already commenced.

Future Action Plan

Experiences in other countries have shown that a well-functioning MTEF is not realized overnight, but instead it requires steady work on multiple fronts. Given Zambia's current challenges in institutional capacity, it should strengthen budget planning by targeting several important components:

(a) forward year program planning,
(b) bottoms-up costing and cost projections,
(c) aggregate resource forecasting,
(d) rigid adherence to budget ceilings, and
(e) consensus building on the functional allocation of resources.

Forward year program planning. To successfully implement some of the programmatic and policy changes that would help bring government commitments inline with resources, GRZ should have a multi-year planning horizon that is linked to the budget process. In other words, GRZ needs a decision-making framework or review process in place that enables it to propose policy and programmatic decisions whose implementation can extend beyond the immediate budget year. If budget preparation occurs in year x, the line ministry would have until the beginning of year x+2 to fully implement the policy or program changes. This represents a commitment by GRZ to (i) identify a few important target areas in which programmatic changes could be introduced to lower their structural costs; (ii) reach agreement with the responsible ministry that the changes will be studied and implemented; (iii) follow-up that they are implemented; and (iv) reflect their implementation in the budget decisions for the next year. For the sake of feasibility, the multi-year planning horizon recommended here is merely one year beyond the budget year.

Yet, this forward-year program planning is not exclusively the responsibility of MFNP. Indeed, because it includes reviewing government wide policy priorities, the exercise should really involve close collaboration between MFNP and the Cabinet to establish cross-sectoral priorities. While MFNP is critical for providing a technical evaluation of the full cost of various government commitments, others would normally make the decisions as to which of those commitments to reduce. The BFP for 2003 was a first step for MFNP in involving the political level of government more deeply in the budget preparation cycle. Indeed, while the creation of a planning department within MFNP should help, going forward Government may still need to clarify how this new department's work will relate to the activities of Cabinet Office, State House, and other policy coordinating offices of the government. One consequence may also be the need for strengthening Cabinet Office in planning and budgeting.

Bottom-up Costing and Cost Projection. A good budget should have as one of its core inputs bottom-up cost projections for maintaining the existing level of services. This provides a baseline cost of continuing public services at the current level of quality and coverage. To do this requires line ministries to understand the factors that drive the costs of their major programs and activities and to be able to summarize them. Because the Yellow Book structure is not programmatic, it may take additional effort by line ministries to present information on their major activities. One of the outputs should also be information about the workload or level of service being provided.

MFNP and cooperating partners working together, possibly through the prism of an annual Public Expenditure Review (PER), could help line ministries review their projected costs, their financing requirements, and their highest priority areas. The aim of these cost projections is to determine to what extent they are sustainable. And if not, then to facilitate the process of making choices concerning what activities should be preserved and which abandoned or curtailed. In the case of capital projects, this may serve to reduce the quantity that are included in the Yellow Book, but increase the likelihood that those included can actually be funded. Currently, this information, for both recurrent and investment activities, seems to be largely lacking or not used by MFNP, because budget allocations frequently bear little relationship with the cost of the program or activity. Gaining a deeper understanding of the true cost of government would be a substantial step toward establishing MTEF and for budget allocation decisions to be based on this information. Although IFMIS would facilitate the process, the existing records may be sufficient to provide initial guidance.

In addition to understanding the programmatic costs, the MFNP would want to also have a reliable inventory of public sector liabilities (arrears) and projections of the cost that will accrue for non-payment. This would serve as a starting point to assist the Cabinet developing a medium term plan for prioritizing and liquidating arrears.

Aggregate resource forecasting. MFNP should strengthen its medium range forecasting of domestic revenues and improve dialogue with donors about expected medium term resources. This projection of the overall resource envelope is essential if GRZ is to transform the PRSP into a useful policy document. Without the constraints being reasonably evaluated, it is difficult to know how much prioritization should occur. Since there will always be some uncertainty around revenues, MFNP should also consider ways in which budget formulation can appropriately assess the risks and to reduce their potential impact on core activities of the government.

Rigid adherence to annual budget ceilings. GRZ can also prepare the terrain for an MTEF by more rigidly enforcing spending ceilings based on the annual budget. A prerequisite for an MTEF to have usefulness in planning is that the annual budget is itself a credible and implementable document. MFNP and Cabinet Office may need to jointly share responsibility for ensuring that budget ceilings are respected. If additional resources are needed, Parliament should be requested ex-ante to authorize a supplemental appropriation and offsetting sequestrations (rather than ex-post).

Consensus-building on the functional allocation of resources. GRZ should consider introducing into the budget cycle a stage during which resource allocations are debated at a broad, strategic level well before the budget is presented to Parliament in detailed line items. Such a presentation would communicate the government's broad priorities among sectors or functions over a medium term horizon, including the shift of resources between sectors/functions that is implied. Doing so would have two main advantages for the Government. First, it would limit the amount of information that needs to be absorbed by Parliament at one time, and thereby create a more focused discussion around major policy issues (for example, should spending on health rise relative to spending on defense, should the overall budget increase by 5 percent or 25 percent). This may be especially relevant in the current Parliament. Before there is any plenary discussion of the Yellow Book, GRZ could present the broad parameters to Parliament in a separate document. This not only benefits Parliament and civil society, but it also focuses the Government's attention to outlining its medium range objectives.

A second advantage of the medium term allocation projections is that it can provide a basis for line ministries to conduct medium range planning, and for cooperating partners to align their interventions with government priorities. Even if the allocations are not binding on MFNP or the Government, they may still introduce a measure of predictability for line ministries and help frame government's dialogue with donors.

The Bank can provide technical assistance if necessary to enhance capacity within MFNP to develop the parameters document. For example, while there are difficulties in predicting inflation and future revenues, the value of the projections could be enhanced by including the allocations as a percent of total spending and/or as a percent of GDP. Likewise, categories of spending could be left rather broad. The South African MTEF, for example, shows allocations for four broad sectors, within which are eleven functional categories. The Bank's recent PRSP Fiscal Framework analysis also provided a potential functional categorization that could be used. Besides presenting a functional breakout of spending, MFNP would be well-served to include distributions by economic classification (for example, how will spending on PEs change relative to spending on domestically-funded investment). The period covered could include spending for the prior year, estimated spending for the current year, and proposed spending for the budget year and the two years following. After some experience using the medium term projections, there should be growing incentive or ability to make them more binding or to limit the level of change. However, in the first couple of years GRZ would focus on beginning the process, using out-year estimates as only indicative.

To introduce these kinds of projections, the relative roles of MFNP, Cabinet, and State House may need to be updated. Indeed, arriving at a consensus within government around the medium term functional allocations may require more coordination during the budget cycle than has occurred in recent years. MFNP staff should start now to work out a timetable and relative responsibilities of each institution. One possible sequencing is the following:

- Develop a macroeconomic framework, budget guidelines, and potential sectoral allocations
- Submit draft macroframework, budget guidelines, and sectoral allocations to Cabinet for review
- A Green Paper is prepared for Parliament and civil society to review
- Budget hearings between MFNP and line ministries, followed by draft budget and MTEF preparation by MFNP.
- Cabinet approves final budget ceilings for ministries
- MFNP finalizes the budget
- Draft MTEF is submitted to Estimates Committee of the Parliament
- Final budget and MTEF are submitted to Cabinet.

Presentation of the Budget

The budget presentation's quality has a direct bearing on the level of transparency in public finance. In Zambia, the format and lack of comprehensiveness in the budget presentation have in many ways limited the ability of Parliament and civil society in exercising their rights to monitor the Government's policies. Some aspects of this problem have been discussed in other sections of this chapter. First, is the fact that the budget lacks completeness in the expenditures which are covered—major items that have a bearing on fiscal management are left out of the budget (Section 4-B). Secondly, the current budget classification system is unhelpful in delineating the distinct programs and activities of the government, or the economic nature of the spending (Section 4-C). This section builds on the earlier two to present a brief summary of how budget presentation could be improved.[28]

28. The Bank acknowledges that it has not reviewed all of the documents that are presented to Parliament as support material to the Yellow Book. Thus, some parts of the materials proposed here might already been given to Parliament as accompanying reference documentation.

Recommendations

Early agreement with Parliament on the overall macro framework and major functional allocation of resources. As described in the preceding section of this chapter, Parliament and Government should debate the overall framework of the budget separately and prior to the submission of the Yellow Book. This would enable analysis to remain focused on the economic assumptions and overall strategic direction of the Government before presenting detailed line items.

Historical data on expenditures. Good budgets will have historical data with which Parliament can compare the current budget proposal. At a minimum, MFNP should be expected to show a side-by-side comparison of three periods: (a) actual expenditures for the prior year, (b) an estimate of expenditures for the current year, and finally, (c) estimates for the budget year. The only historical data presented in the current Yellow Book is the current year's budget estimates, along with any supplementary appropriations. This is wholly inadequate for Parliament to evaluate the changes from year to year because the budget estimates bear no relationship to the actual expenditures. (Even with the supplementary appropriations, they are wide divergences from the actual expenditure.)

Prospective economic trends. As noted in the previous section, Ministry of Finance should also provided a forecast of future revenue and expenditure trends for the next two years. This should not be as detailed as the budget, but on a very broad aggregate basis—at least for the major expenditure categories—Parliament should receive economic projections along with the assumptions that underlie them. Ideally, this should be presented to Parliament as part of a pre-budget package, which would include an estimate of future sectoral allocations. Ministry of Finance should get acceptance on the aggregate resource and expenditure levels before allocation to the detailed budget estimates.

Status of Capital Expenditures. At least for domestically financed capital expenditures (and eventually for all capital expenditures), Government should indicate in supplementary budget documents the status of each of project. The status report should indicate the original cost of the project and the year, the amount expended to date, and the future anticipated cost. It should also indicate the approximate rate of physical completion.

Summary tables and analysis. The budget document should also present summaries of major budget categories. For example, it should be possible to see at a glance the total budget for PEs for the Ministry of Education, and to compare that with the total PEs for Ministry of Health. But under the current format, PEs for Education are spread across several budget heads and are never totaled. At a minimum, the budget would be more useful if it presented a comparison of expenditures by ministry and major economic classification. In addition, it should provide tables comparing the major changes from year to year.

Authorized employment levels. The Yellow Book may be more useful if it showed not only the authorized budget for PEs, but also the number of authorized positions and the actual headcount as of the date of its submission.

Changes in Debt Stock and other liabilities. The budget should disclose an estimate of the current debt stock and other liabilities of the Government, along with any changes that are forecast for the budget year. Additions to sovereign debt, in particular, should not be incurred without the consent of Parliament.

Narrative on the Budget. In addition to data described above, the budget document(s) needs to provide a much better narrative of the proposed policies. The "budget speech" that accompanies the tabling of the budget is too generalized, while the Yellow Book itself is virtually silent. Some issues which the budget document should explain in narrative include the following:

- What are the major changes in the budget compared to the prior year—both in terms of budget estimates and with respect to the policy or program itself—and what are the reasons for the changes.
- Reasons for any major changes have occurred in tax policy.
- The major economic and programmatic assumptions. This might include any risks that would have a significant financial impact on the cost.
- Some descriptive information on the objectives and purposes of the proposed activities, including quantitative data on workloads.
- Discussion of changes in financial assets and liabilities, non-financial assets, employee pension obligations, and contingent liabilities.

Improved budget classification. As noted in section C of this chapter, the budget documents should include a programmatic classification, as well as an improved economic classification.

An electronic format. In addition to the Yellow Book, transparency could be enhanced by making available to Parliament and civil society an electronic version of the budget data.

Incorporating all of these changes in the presentation of the budget will not be feasible overnight. But these represent standards for improved transparency that the Zambian Government should be striving for, and which Parliament should over time be demanding.

CHAPTER 5

Budget Execution and Control

Problems in budget execution and budget control lie at the root of Zambia's fiscal failure in the past decade. This chapter discusses these issues, beginning with the cash rationing system, which caused significant deviations between budgeted and actual allocations of expenditures. The cash rationing system also led to a high degree of uncertainty over the timing of those allocations. Together with other factors such as the structural under-budgeting at the start of the year and ineffective control mechanisms, this system contributes to large build-up of arrears. Actions to bring arrears under control need to include policies and procedures for limiting commitments as well as improved budget preparation measures. Two key areas that pose the highest financial risk to the government budget are payroll and capital expenditure controls and they are reviewed in detail in this chapter. Finally, a factor that contributed to the lack of effective budget control in the past was the government banking arrangements; Annex E discusses progress in this area.

Despite the substantial attention drawn to the technical aspects of implementing and controlling the budget, there is a broader and overarching need for political commitment to enforce the existing rules and improve accountability. As the second section of this chapter highlights, the legal framework places the Controlling Officer at the center of budget execution. However, he/she is appointed by the Minister of Finance and accountable to the Minister for the proper execution of each budget head. The system will fail to work when the Minister of Finance is not in a position to hold Controlling Officers responsible for their management of the budget head.

Cash Rationing

The single most important characteristic of Zambia's budget execution of the budget has been its reliance upon "cash rationing" to determine resource allocation. Although an understandable response to macroeconomic crisis at the time of its creation in 1993, the cash budgeting process has persisted until today in ways that are highly destabilizing to effective public expenditure management. Indeed, cash rationing has essentially rendered the Yellow Book unreliable as a predictor of resource allocations to line ministries. Instead, actual expenditures by line ministries often bear little relationship to the budget initially approved by Parliament. The World Bank has attempted to moderate some of the negative effects of cash rationing and to encourage cash releases that are more consistent with budget estimates. These efforts have born some measure of success, but there remain significant reforms needed if line ministries are to attain predictable and steady resource flows in order to carry out their programs. In the future, MFNP's cash release decisions need to be based on an analytical assessment of cash needs and a rules-based process of allocations—bounded ultimately by spending limits agreed upon in the context of a meaningful budget.

Origins of Cash Rationing

In the 2000 study, "The Cash Rationing System in Zambia," the Bank presented some of the history and rationale for the current cash budgeting process in Zambia. Introduced in 1993, the cash budgeting system was part of a fiscal adjustment program aimed at reestablishing financial stability and bringing down the runaway inflation. The system was based on the principle that no cash would be released to line ministries and other budget heads for payment of their expenditures before sufficient funds were available in the Treasury's central account with BOZ to fully cover those payments.

The cash budget has evolved significantly since its inception, with one of the most important changes occurring in 1997 when the daily funding was converted to monthly funding. However, the actual decisions about how much each ministry and other budget heads will receive each month in each expenditure category are still taken ad hoc by a committee within MFNP. The committee's aim is to respect the quarterly benchmarks established with the IMF, while responding to the new and competing demands of the line ministries. In the end, it is the decisions of this committee rather than the voted budget that determines the spending levels of each of the line ministries.

Some general criteria guide the cash release decisions. Traditionally, the first priority has been given to domestic debt service, contingency-set-aside for unexpected revenue shortfalls, and personal emoluments.[29] The social sector has also been protected under an earlier agreement with IDA at 36 percent of total domestic discretionary spending. In contrast, funding of RDCs, grants, and capital expenditure (for non-social sector activities) have been given lower priority, with domestically financed capital expenditures being little more than a residual. But across sectors, the data has shown a more varied story with some ministries clearly doing better than others in respect to their allocations for RDCs and grants.

29. Until 2002, servicing of the foreign debt was financed overwhelmingly by foreign balance of payments (BOP) support and as such remained largely outside the cash budget process. Beginning in 2002, if BOP contributions fall short of the amount expected, however, it can have an impact on the cash budget.

Analysis of The Problem

Impact on the Type of Spending. Despite the semblance of fiscal discipline it gave, the cash budget had a clearly adverse impact on the quality of public management in line ministries. A distinguishing characteristic of the MFNP's cash release policy has been that it fails to follow any consistent or predictable pattern. Without any basis to know how much they would receive (and when), line ministries have had little means by which to plan basic operational and management needs. Even if releases were going to be below the monthly budgeted amount, line ministries often felt that it would be essential to know in advance what that amount would be so that they could adjust accordingly.

The Bank's 2000 study showed that the cash rationing system was responsible for significant dislocations in spending priorities relative to those that had been agreed to in the Yellow Book. The study categorized ministries into three sectors based on their primary function—general services, social services, and economic services—and examined the proportion of budget each received. It found, for example, that releases to the general services sector and the social services sector were substantially over budget (128 percent and 113 percent respectively), while releases to the economic sector were only 62 percent of budget. (The overall execution rate was about 92 percent.) Thus, there were large variances between the budgeted and actual allocations. Although social sectors did relatively well, this could be explained by the IDA agreements by which the government committed to maintaining social sector releases at a minimum of 36 percent of total domestic discretionary releases.

In addition to the realignments across sectors, the study showed huge changes in the composition of spending within the sectors—away from RDCs and towards personal emoluments. In brief, PEs went up in all three sectors due to a wage hike during the year, but RDCs increased only in the general services sector of the budget—and there it skyrocketed to 177 percent of budget. In contrast, RDCs for economic services were dramatically lower (~36 percent). Similarly, the analysis showed that releases for grants were very close to the original budget (97 percent). Yet, this was the result of two opposing trends—substantial overspending by general public services, compensated by massive cuts for economic services (~47 percent) and minor cuts for social services. Given the apparent political pressures to increase general services while at the same time protecting social sectors, it is not surprising that economic services were left to bear the brunt of cuts.

Still, it is domestically financed capital expenditures that traditionally tend to suffer the worst. The study revealed that these were cut by nearly half—though not so much the purchase of movable assets (cars, computers; ~9 percent) as cash releases for investment projects (~51 percent). There were also differences in funding of capital expenditures across the sectors. Cash releases to the group of general public services were largely intact, but slashed for social services and economic services (~38 percent).

Impact on the Quality of Spending/Timing of Resources

Not only has the cash budget impacted the annual amount that line ministries receive, but it has also led to a high degree of uncertainty over the timing of those allocations. While the actual releases may be made at the same time of the month, the amount is usually unknown to line ministries until they actually receive it. The Bank's 2000 study showed that aggregate figures on cash releases could mask the magnitude of the swings being experienced by individual ministries. For example, Ministry of Health RDCs should have averaged about K1.5 billion in 1998. But actual releases for MoH ranged anywhere from 0 to 4.6 billion per month. Grants for the same ministry ranged from 2.0 to 9.3 billion despite a monthly budget of K4.8 billion. A similar story was found at the MoE and Ministry of Agriculture. (See Table 11). Often shortfalls are compensated for by a large jump in a succeeding month.

Table 11. Cash Releases to Select Ministries for Key Expenditure Categories during 1998 (K' billion)

	Ministry of Health			Ministry of Education			Agriculture	Works + Supply
	Personal Emolume.	RDCs	Grants	Personal Emolume.	RDCs	Grants	RDCs	Capital Expenditures
January	3.1	1.3	4.4	7.3	2.1	2.0	1.6	0
February	2.4	1.2	4.9	7.3	2.0	2.0	1.2	3.1
March	3.8	2.2	3.9	7.3	1.6	2.0	0.6	0.2
April	2.0	2.0	5.2	7.3	4.1	2.1	0.8	5.2
May	2.0	1.1	4.2	7.3	2.4	1.5	2.1	0.2
June	2.0	0	2.0	7.3	0.3	0.7	0	3.7
July	2.0	1.2	9.3	7.5	2.2	1.8	0	5.8
August	2.0	0.9	4.0	7.8	1.5	2.1	0.8	5.1
September	2.0	0.4	3.1	8.8	2.6	1.1	0.5	6.1
October	2.0	4.6	5.0	10.8	3.0	1.8	2.8	9.9
November	2.0	0.7	5.1	7.8	4.8	2.1	2.0	4.4
December	2.0	2.4	7.1	7.8	1.9	3.8	0.3	7.2
Budget*	2.0	1.5	4.8	7.9	2.4	1.9	1.0	4.2

Source: Ministry of Finance and National Planning.

One might have expected to find some pattern of predictability in monthly expenditure levels, but instead the Bank's analysis showed that the pattern was essentially random. For example, one hypothesis had been that there would be a link between monthly government revenues and monthly cash releases. However, a regression analysis for the years 1995–98 showed that only 44 percent in monthly variations in expenditures was explained by variations in revenues. In fact, government revenues fluctuated less than cash releases, particularly for RDCs, and those fluctuations were characterized by a seasonal trend—low during the first quarter, average during the second quarter, and gradually rising to a peak in December. The statistics further indicated that Government had been quite successful in projecting annual revenues at the time the budget was prepared. During the first three of these years actual revenues slightly exceeded budget projections and in the fourth year the actual shortfall was less than 0.5 percent.

Cost to Government Procurement

Inevitably, unpredictable funding will lead to higher costs of procurement and inefficient operations as ministries try to adjust to their environment. For example, it may cause ministries to make purchases during periods or in sizes that are less economical than others. By buying on supplier credit, many had to pay higher prices. Or they may simply make inefficient use of their assets and staff because of complementary inputs shortages, e.g., staff or assets may sit idle until other critical inputs can be purchased.

The cost of unpredictable cash releases may be highest with capital projects. Because of the structured work plans involved in carrying out physical projects, the funding sources need to be able to support them. When contractors are not paid and work has to slow down, this obviously leads to higher cost, if not wastage or spoiling of previously performed work. Within MFNP there have been various stories of projects that have been impaired or cancelled because funding did not arrive when needed to support the physical progress on the project. Still, MFNP does no real cash planning in order to match cash needs throughout the year with the timing of inflows.

Actions Taken to Date

The Bank has assisted the Government to reform the cash rationing process and to introduce greater predictability and transparency through the Fiscal Sustainability Credit (FSC). Under FSC, the Government agreed to develop a quarterly cash allocation plan to be communicated to line ministries prior to the start of each quarter. The plan would detail the minimum release that ministries could expect for RDCs and Grants for each month of the quarter. This would apply to all ministries in every sector, although it would have greatest significance for those in the social and economic sectors. As MFNP began to gain sufficient experience with the quarterly plans, it was hoped that they would eventually be able to move to a six-month allocation plan.

Through quarterly plans and subsequent correspondence to line ministries (LMs), MFNP agreed to guarantee ministries at least 80 percent of their budgeted RDCs and grants for the quarter. The releases did not need to be the same each month, but MFNP needed to communicate what the amounts would be and assure that the sum was at least 80 percent of budget. It was assumed that PEs would be released at 100 percent. By allowing RDCs and grants to be as low as 80 percent, it would provide MFNP with a measure of flexibility to respond to unexpected demands or to meet seasonal needs that may arise for a particular ministry. Yet, it also provided a floor for line ministries to be able to continue to cover some basic operational needs. As a continuing measure to protect the social sectors, FSC1 also required 36 percent of domestic discretionary expenditures to be allocated to the social sectors. Hence MFNP aimed to fund the ministries of Education and Health at 100 percent of budget.

Since revenue collection might not follow the same pattern as expenditure needs within the quarter, the Bank helped MFNP to establish a US$15 million revolving credit with BoZ. This was intended to help cover the month-to-month fluctuations that would occur in revenue and still enable MFNP to meet its commitment to fund 80 percent of RDCs and grants. FSC1 also specified that if a deficit were to be incurred in one quarter, then the next quarter's plan needed to be reduced in order to cover it. Moreover, it specified that if at any time MFNP were unable to respect the 80 percent commitment for ministries, that it should provide an explanation of the reasons and the criteria used to reallocate funding it a different way.

Experience Implementing the Quarterly Plan

MFNP has produced the quarterly cash plans since the third quarter of 2000, but the actual implementation of the plans has only partially fulfilled their purpose. Since the first quarter of 2001, when the Bank first began to compare carefully the plan with actual releases, the results have been fairly mixed. Discrepancies between planned and actual releases were generally greatest during the first quarter but have improved somewhat over the course of the year. The first quarter plan proposed an across the board 80 percent guarantee for all ministries. Given that actual releases overall were substantially more than the total amount allocated in the plan, many ministries received more than the planned amount. Yet, most of those that received additional amounts were concentrated in the general services sector, while some ministries in the economic and social sectors received amounts considerably lower than planned (that is, lower than 80 percent of budget). During the second and third quarters, however, the distributions of cash releases were more balanced across sectors.

Analysis prepared by MFNP itself showed that for the full year 2001 there remained a bias in cash releases towards PEs over other expenditure categories and towards administrative/general government sector over other sectors. (See Annex C.) While the overall execution was 38 percent over the GRZ budget estimate, the largest increases were in PEs, which were 48 percent over budget and the smallest in grants (15 percent). Across sectors the administrative/general government sector did considerably better than the social and economic sectors when it came to RDCs and grants. For example, RDCs for administrative ministries were on average 58 percent over the budget amount, but 20 percent below budget for economic sector ministries. With respect to grants the administrative sector benefited from a 38 percent surplus, while the social sector saw a decrease of 3 percent.

Future Action Plan

The FSC1's recommendations have had two important purposes: (i) to encourage a more predictable stream of funding to LMs, and (ii) to make that stream more consistent with the budget estimates. It has done so by encouraging development of a quarterly plan that is communicated to LMs and by promoting transparency on the implementation of the plan (through publication in the MFNP's Macro Indicators journal). As noted earlier, the results are mixed. Cash releases have become less volatile on a month-to-month basis. Ministries have received from MFNP more consistent cash release amounts even if they sometimes fell below the initial plan amount. On the other hand, the cumulative cash releases still show a considerable variance from the budget estimates. In particular, economic services ministries still tend to receive less and general services ministries more than budget.

Recommendations under FSC1 should continue to have an important role to play in the interim or transition period until budget preparation and execution are taken more seriously and fiscal discipline is stored. In particular, the "requirement" to maintain funding to LMs at a minimum of 80 percent of budget (for RDCs and grants) is a partial incentive to prepare more realistic budgets and to maintain tighter control during the year. Ultimately, LMs should receive closer to 100 percent of their budget estimates, but this is would most likely occur over a medium term horizon as a part of broader PEM reforms.

Going forward, the Government needs to pay special attention to three broad areas for improving the cash release system:

(a) Quarterly plans need to be based in an ongoing process of rigorous cash management for domestically generated resources. In other words, they should be driven not by a blanket 80 percent allocation for all ministries, but through analysis of the expected aggregate resources and the requirements of ministries.
(b) MFNP should continue to encourage transparency in the cash release system by publishing amounts received by each ministry.
(c) MFNP should commit itself to fully implementing the planned budget, reinforced by the commitment of the political leadership to comply with it.

Annex C expands upon and discusses the challenges in each of these areas. Below is a summary of the recommendations described therein.

Possible Action Steps:

(a) Assign institutional responsibility for cash management, including the development and updating of quarterly cash plans in collaboration with revenue departments, Investment and Debt Management Unit, Economic and Technical Cooperation Unit, Accountant General, Planning and Economic Management, and line ministries.
(b) Develop quarterly cash allocation plans that are based on comprehensive forecasting of the expected cash inflows for the quarter, analysis of line ministries' cash requirements for the quarter, and Government's immediate policy priorities. The quarterly plans should function as expenditure ceilings for line ministries.
(c) Incorporate capital spending in the quarterly allocation plan based on input from line ministries concerning contractual cash requirements.
(d) Demonstrate to line ministries that the plan will be implemented each month, that is, actual cash releases will be consistent with the plan amount.
(e) Provide some minimum guaranteed level of monthly cash releases for RDCs and grants (70–80 percent, for example)
(f) Develop procedures for how and when the quarterly plan is updated (e.g., whether it should be a rolling quarter without revisions to the prior planned months).
(g) Continue to publish information on cash releases in newspapers, or in an alternative media that assures access to the information by civil society. Information should compare budget versus actual release for selected ministries and/or subheads.
(h) Continue to monitor and report on deviations between the quarterly plan and actual amounts.

Revenue Controls

Revenue collection is one of the few areas in the Zambian public finance system that works very efficiently. With a 1993 Act of Parliament, the Zambia Revenue Authority (ZRA) was created and entrusted with the responsibility for collecting all government tax revenues, including income taxes, VAT, and custom and excise duties. The ZRA is supervised by a Board whose members are appointed by the Government from the public and private sectors. The Board reports to the Minister of Finance who is accountable to Parliament for the performance of the Authority. The Authority prepares annual financial statements which are finalized within three months of the end of the year, audited by an independent firm of auditors and laid before Parliament within six months of the end of the year. Also, its accounts are examined by the AG.

MFNP and ZRA jointly set the target of revenues to be collected. The estimated revenues are included in the annual budget that is laid before Parliament by the Minister of Finance. The revenue collection is monitored regularly by MFNP through daily reports on Control Account 99 from the Bank of Zambia, monthly reconciliation between MFNP and Zambia Revenue Authority (ZRA), and quarterly and ad hoc reports from ZRA. ZRA has put in place arrangements to ensure that all revenues collected in Lusaka and Kitwe are banked promptly with the Bank of Zambia, while revenues collected from remote areas are banked promptly with participating commercial banks for onward transmission to the Bank of Zambia within 4–14 working days. All revenues collected by ZRA are deposited in the government general revenue account. The source of the ZRA's funding is the Government budget. There are no ad hoc exemptions from taxes. Every exemption requires Statutory Instruments, in effect, an Act of Parliament that provides appropriate instructions on the exemption.

Actions Taken to Date

Some of the important steps Government has taken to ensure proper collection of revenues and adequate monitoring of the revenue collection process include the following:

- ZRA is adequately staffed. It was set up as a government agency outside the civil service recruitment and remuneration arrangements. It therefore operates on a different salary scale from the civil service and is able to compete effectively with the private sector for skilled and experienced personnel.
- The Authority has adequate material resources to perform its functions, although much of the funding has so far come from donors.
- ZRA is relatively independent and able to apply the full letter of the law in collecting government revenues. It is, therefore, not bedeviled by questionable exemptions—the exemptions granted are backed by statutory provisions.
- The accountability arrangements for ZRA are reasonably robust. They include a supervisory board, reporting to Parliament through the Minister of Finance, external audit conducted by private audit firms, and audit by the OAG.
- The arrangements for transmitting revenues collected to the government account is fairly adequate, given the state of Zambia's banking network.

Future Actions

The Government needs to capitalize on the current strengths of ZRA and ensure that the Authority can continue to operate efficiently. ZRA is adequately resourced at the moment due to generous funding from donors. However, there is a need to put in place a mechanism that will assure adequate funding for ZRA if and when donor funding stops.

Expenditure Control

The expenditure control system in Zambia is built around the principle that Control Officers are responsible for execution of the budget head, and that they are held accountable by the Minister of Finance for proper management. Significant problems arise when the expenditure rules are not enforced, and when Controlling Officers are not held accountable.

Legal Basis of Expenditure Control

The Constitution and Finance Act stipulate that: (i) moneys shall not be expended from the general revenues of the Republic unless the expenditure is authorized by a warrant under the hand of the President; (ii) warrants shall not be issued by the president unless the expenditure is authorized by an Appropriation Act;[30] (iii) M-MFNP shall appoint Control Officers for each expenditure head, who shall be responsible for budget execution and who shall be the Chief Accounting Officer of the relevant expenditure head, and such Accounting Officers shall keep such books and render accounts as may be prescribed, or as may be directed by the PS-MFNP; and (iv) the M-MFNP is ultimately responsible to produce annual financial reports and present them to the Parliament within nine months after the end of each fiscal year.

In conformity with the Constitution and the Finance Act, the Minister of Finance and National Planning appoints the Controlling Officers (CO) for each of the expenditure Heads (51 at present consisting of ministries, provinces, and a few other organizations). Following the budget approval by the Parliament in April of each year, and issuance of the general warrant by the President, the Secretary to the Treasury will issue sub-warrants to each CO. The record keeping of these credits is done by the accounting units at the appropriate level: (i) at Ministries' HQ in Lusaka for RDCs of HQs and offices in Lusaka; and (ii) at provincial offices (Provincial Cos and accounting Officers) for all departments located outside Lusaka. These sub-warrants are the basis for cash release.

The responsibility for budget execution, including creating of commitments, managing of contracts, and accounting and reporting to the MFNP rests with the appointed CO or his/her designated Accounting Officer. The process and steps are clearly described in the instructions, which are reinforced with the provision of appropriate forms and formats are provided for guidance. The institutional arrangements and instructions rely on the segregation of duties as the basis for control. Furthermore, the secondment of Internal Auditors (IA) to each CO is a necessary control mechanism. A simple cash-based accounting system is maintained by each spending agency to form the basis for financial reports.

30. Exceptions to those rules are contained in article 115 (1) and (2). Further exceptions to the above rules are contained in the Finance (Control and Management) Act and substantial authorities are given to the PS-MOF.

Analysis of the Problem

It is difficult to separate expenditure control issues from other parts of the budget process. For example, it is impossible to maintain adequate budgetary control without good budget format, reliable estimates, and timely and reliable historical data (produced from the accounts). Conversely, poor budget execution impacts adversely on the quality of accounts and reports produced. For this reason, the issues raised in this section overlap to some degree with those found in Chapter 6 on accounting and reporting.

There are several problems with expenditure control in Zambia. First, ad hoc systems such as controls via cash rationing discredits the budgetary exercise and undermines the legitimacy of expenditures. The control of expenditure via cash rationing, although sometimes necessary in the short-term, does not always achieve its intended purpose. It relegates parliamentary control and oversight, and creates conflict between the MFNP and the executing agencies. It often contributes to the lack of discipline and non-compliance with rules and regulation. Furthermore, it promotes the end-of-year practice of fitting the actual data into the Appropriation Acts or visa versa (supplementary estimates to match actual data).

Second, many spending departments in Zambia operate as if standing instructions on the cash control mechanism did not exist, although in most cases they stay within the budget envelope. In many cases, orders are placed and payment vouchers are prepared and kept (often unrecorded) until cash is available. Once funds become available, a selected number of vouchers are sent for payment, enough to exhaust the cash. Other vouchers, ready for payment, remain pending for the next release of fund. The bulk of these vouchers form the Government arrears. Because, many of them are unrecorded in the ledgers, the exact amount of arrears is unknown. Ad hoc measures are required for their identification and estimation. However, even with those ad hoc measures, there is no certainty about the exact amounts of arrears. (See the third section of this chapter for a further discussion of commitment control.)

Third, besides the fact that some arrears are not accounted, the practices described above raise two issues: (i) late payment penalties charged by suppliers and the impact on prices quoted by suppliers and/or quality of goods; and (ii) the probable consequence on transparency in the selection of vouchers for payment. Late payment penalties are explicit for civil works certificates but implicit in other invoices. Although the small size of economy and limited market for suppliers can be the reasons for availability of suppliers' credits to the Government, delayed payments are likely to have an impact on the price (or quality) of goods, particularly when the commercial rate of interest is as high as 40 percent. With respect to civil works contracts, and other competitive based contracts, the late payment charges are added to the invoices. For a few invoices examined, the late payment interests and other additions resulted in an almost 100 percent increase in the payment for the works done. When controls are weak, this could also be used as means for financing kickbacks by pre-dating invoices (submitting invoice before the work is done). The lack of transparency in selecting vouchers for payment creates a rent seeking opportunity and could create an avenue for corrupt practices. (See Section F in this chapter for further discussion on capital expenditure controls).

Fourth, several other irregularities have also been observed: (i) funds released by the Budget Office were earmarked and the contracts (and implicitly the contractor) for which funds were released were identified by the Budget Office in several cases; (ii) in one of the spending agencies, checks were issued before delivery of goods and those checks were delivered to the procurement staff (or stores) for exchange against goods; and (iii) in some cases overdrafts have been used by the spending agencies to pay for expenditures over and above the budget. Those cases relate to the influential spending agencies such as the National Assembly, Ministry of Defense, the President's Office, and few other agencies.

Fifth, the control mechanisms are based on segregation of duties, and depends on full compliance with the rules. Changes have occurred that made the controls ineffective, among which is the increased volume of transactions. Staff are not well trained and, although manual and guidelines exist, staff do not have copies for reference. Internal audit is weak. The main work performed by the IA consists of pre-payment audit (or vouching). Inadequate systems audit or risk assessment takes place. While the quality of IA staff at the MFNP seemed good, IA staff at the sector ministries' level seem to lack rigor in their work, including reporting. For example, working documents used in their work were not available.[31] (See Chapter 6 for further discussion on Internal Audit.)

Finally, the financial management staffing is generally inadequate. A team of well qualified and dedicated/motivated staff needs to be in place to ensure that rules are applied as designed and that adequate controls are maintained over expenditures. The incentive system needs to be improved to attract the right caliber of staff. (See Chapter 8 for a fuller discussion of human resource issues.)

Future Action Plan

The purpose of expenditure control is to provide reasonable assurance that public funds are spent in accordance with parliamentary authorization and that the set objectives are achieved. To this end, it is crucial that measurable objectives are clearly set and that the approved budget is respected. In order to address the current weaknesses in the expenditure control process, the following measures should be considered:

- Strengthen and modernize the Internal Audit (IA) arrangements by adopting international standards best practices, and improving the capacity of IA in all ministries. (See chapter 6 for further discussion on how to strengthen Internal Audit.)
- Carry out a comprehensive review of business processes in order to improve the control system, in particular the commitment control, and data integrity.
- Provide specific directives on internal control to improve staff and strengthen staff training on internal controls, especially for restructured institutions so that the control framework remains in tact.
- Enforce existing rules and sanctions.
- Prepare and execute a plan to repay all outstanding arrears.
- Tighten the legislation in order to prevent loopholes in executing expenditures outside the budget approved by Parliament.

31. One of the tasks that recently has been given to the IAs is to produce the amount of arrears. In one case that we verified, the amount given by the IA did not match the amount produced from vouchers by the accounting staff. There was no backing of data produced by IA while the accounting staff had the full information about each voucher and the totals provided.

- Strengthen parliamentary oversight and control by way of regular reporting to Parliament by the Executive, and adequate arrangements by Parliament to evaluate and act on the financial reports.

Commitment Control and the Arrears Problem

Analysis of the Problem

The accumulation of expenditure arrears is a persistent symbol of the public expenditure management system's ineffectiveness. In its 1997 report to the Government, the IMF devoted considerable attention to the problem of arrears. It noted that MFNP had set aside in 1996 about K15 billion to meet the stock of arrears assessed through 1995. It also went on to recommend an audit of the existing stock of arrears and measures to control future accumulations. Yet, over time things seemed to worsen rather than improve. In 1999, MFNP had to devote nearly 9 percent of budget resources, or K121 billion, to the clearance of arrears. Although the stock of arrears fell for a brief period afterwards, they have again climbed dramatically. Estimates for end-2002 suggest that the total arrears may be approaching 400 billion kwacha.

There are a number of factors that contribute to the commitment control and arrears problems, many of which have been noted by IMF missions. First, there have been institutional weaknesses and lack of capacity to fulfill accounting requirements. For example, there had been concern that many of the accounting staff lacked clear understanding about the commitment process and what exactly constituted a commitment. In response to this, an IMF resident advisor developed a training course for identifying commitments, accurately completing the monthly outturn reports, and general principals of accounting. The training, which covered accounting staff in every line ministry, was viewed as useful and served to highlight some of the deficiencies in accounting knowledge that had existed. The advisor also noted the lack of appropriate written guidance on the policies and procedures to be executed by the accounting staff.

Secondly, some arrears may be a consequence of the variation between budget amounts and the actual cash releases. The budget estimates are not intended to represent a guaranteed minimum but rather a maximum expenditure, and macroeconomic circumstances can dictate the need for adjustments. However, some line ministries may simply insist on committing the full amount authorized in the budget, or they may have implemented work plans based on the full budgeted amount. The annual warrant does authorize ministries to spend up to the annual budget amount, but the cash release process has been MFNP's main tool for limiting spending. Given the ad hoc nature by which the cash rationing process works, it is not surprising that ministries may incur commitments that are within the budget estimates but in excess of the cash release by MFNP. There has been no analysis to assess to what extent arrears may be created for recurrent expenditures that are within the original amount budgeted.

A third factor contributing to potential arrears is the structural under-budgeting for activities at the beginning of the year. In a 1997 report, the IMF noted that "In areas like education, health, and prisons, the need to provide food for staff/residents has led to continued orders from suppliers even though the cash allocations were inadequate to meet them." Consistent with this, a Bank mission for preparation of the 2001 PER met health ministry officials who suggested that this was likely to be occurring at the University Teaching Hospital as well. They explained that some necessities of maintaining patient care meant that they had a cost structure that was rather inflexible and could not be reduced overnight. Other ministries are also confronted with budgets that are below the fixed obligations that they have. Under these circumstances, ministries often rely upon supplier credits to continue to obtain goods and services despite their shortage of cash. Because of weak customer demand in the private sector, there are suppliers who are willing to take chances with the Government in order to make a sale.

Fourth, overcommitments may reflect an attempt by some ministries to increase their budgets and to thereby initiate new activities that were never budgeted. Rather than making difficult tradeoffs, some ministries may choose to overcommit with the anticipation that they can receive additional funding from MFNP to meet their requirements. Given the flexibility offered to MFNP by the cash rationing process, overcommitment becomes a viable strategy for some ministries. Indeed, the past training seminars have suggested that large levels of outstanding commitments by a given ministry often had little to do with the qualifications or expertise of its accounting staff. Instead, there were institutions with very capable staff who readily understood that they were entering into commitments that exceeded their budget. Moreover, some of these excess commitments may never turn into arrears because MFNP responds to the pressure by increasing the cash release for that ministry.

Yet, the largest and most costly source of arrears tends to be from capital projects managed by the Ministry of Works and Supply. It is not difficult to understand how these arrears accumulate and the danger that lies in them. As noted earlier, the releases for capital expenditure have generally been given the lowest priority in the cash budgeting process. Moreover, the timing of the releases is generally erratic, as there is essentially no cash planning done by MFNP. Consequently, arrears build up for nonpayment on contracts where work has been performed. In addition, the lack of payment leads to the accrual of penalties and interest that in turn may create new arrears. Interest rates tend to be high and are generally negotiated by the contractor, without any fixed parameters used by government. Although there are no up-to-date estimates as to what proportion of Works and Supply's total arrears are due to these types of interest, penalties, and other non-payment of signed contracts, the IMF estimated it could be as high as 75 percent in 1997.

The organizational structure of Works and Supply contributes to the problem. Those responsible for payment of contracts for the ministries various departments do not work with or review the contracts themselves. Thus, they are unaware of the terms of the contracts and the likely penalties that may apply. Consequently, even if cash rationing is necessary with the Works & Supply Ministry, there is little basis by which to arbitrate how that cash should be used. Likewise, it would be difficult for the accounting staff to accurately calculate the extent of its liabilities at any point in time when the contract terms and conditions are managed by the project staff who are organizationally separated.

Actions Taken to Date

The IMF and the Bank have been fairly persistent in recent years in proposing actions to address the problem of overcommitment, as a step to preventing arrears. While one component has been training of accounting staff, a substantial effort has also gone into recommending procedures to bring greater control over commitments. For example, pursuant to an earlier IMF proposal, MFNP created a Commitment Monitoring Unit (CMU). This unit, initially comprised of staff seconded from the Budget Office, the Accountant General's Office, and Internal Audit, was charged with reviewing monthly commitment reports from line ministries.

MFNP has also issued directives to line ministries clearly outlining limits on the amount of commitments that they could enter into. Beginning in 1998 MFNP implemented a requirement that outstanding commitments should not exceed 20 percent of the (monthly) budget provision without consent of MFNP. Before the end of that year, MFNP had tightened the rule to a maximum of 10 percent. Monthly reports on expenditures were modified to permit monitoring of ministry compliance.

Among the problems with MFNP's 10 percent rule was the lack of enforcement. Although MFNP has at various times issued letters to controlling officers reminding them of the rule and the sanctions that could result from violation, the problems persisted. The most recent examples of this have been in the context of the Bank's FSC1. Since the 4th quarter of 2000, the Government has written controlling officers who were in specific violation of the 10 percent rule and informed them that without a written justification, their future cash releases risked being withheld. Still, ministries continue to overcommit. Although officials from the Accountant General's office indicated that there have been cases where they have taken actions against Controlling Officers, these seem to be extremely rare.

Part of the challenge in enforcing commitments is that the Expenditure Monitoring Unit (formerly the CMU) is highly dependent upon the quality and timeliness of reporting from line ministries. For example, during 2001 it was not unusual for reports to arrive late and containing numerous errors or gaps. The Accountant General's office is obligated to follow-up with those that have delayed or where there are inconsistencies in the reporting. In addition, those responsible for reviewing the commitment reports have been typically detached from the office deciding the cash release. For this and other reasons, the commitment reports have generally not been an input into cash budgeting decisions.

Some of the most encouraging actions have occurred most recently, at least with respect to identifying the stock of arrears. By improving the quality of quarterly audits of line ministries and having controlling officers sign "certificates of acceptance," the Internal Audit Department has taken steps that could significantly improve the reliability of arrears estimates. The certificates of acceptance, for example, reduce the likelihood of line ministries "finding" new bills at a later date. The Internal Audit department also had plans to construct a database of individual arrears in 2002, including details on the original due date, name of the payee, and a budget code to which it corresponds. By 2003, it was hoped the database would be fully operational and that it would include a process for recording the clearance of individual arrears as MFNP releases funds to line ministries for that purpose. Though delayed, the arrears database has now been created and is in use.

Future Action Plan

Actions needed to address arrears should target four areas:

(a) inadequate policies and procedures for limiting commitments,
(b) ineffective monitoring and enforcement,

(c) flawed budget preparation, and
(d) inadequate monitoring of liabilities as they are created for capital projects.

Although there are some immediate steps that can be taken, progress in each of these areas will generally require a medium term horizon. Below we examine the kinds of actions that would be appropriate for each area.

Policies and Procedures: Effective expenditure control depends in part upon line ministries having timely information on the level of commitments at the time they are entered into. A workable set of operational procedures are a critical element in making that possible. The IMF began providing assistance to MFNP in 2002 to implement a commitment control system (CCS) in line ministries. Under this system, a requisition would be prepared and examined by the Chief Accountant before a commitment could be entered into in order to confirm that sufficient uncommitted funds were available under the particular line item in the expenditure ledger. If funds are not available, the requisition is refused and no commitment is entered into. On the other hand, if uncommitted funds are sufficient, the Commitment Control Officer (normally the PS or his/her designate) would approve the requisition and enter the new commitment in the ledger. Payment vouchers would therefore only be prepared if proceeded by an approved commitment requisition.

Over the medium to long term, commitment control procedures can be facilitated through the IFMIS. Moving from a manual system, new commitments can be blocked automatically in the system once they reach a specified threshold. Likewise, payments would only be authorized in the IFMIS if proceeded by an approved commitment.

For either the manual or automated system, however, unambiguous expenditure limits need to be communicated to line ministries. These limits should not be limited to cash on hand, or to merely one-twelfth of the Yellow Book estimate. Instead, MFNP must be able to provide some margin for planning that would enable line ministries to enter into commitments prior to a cash release but based on a clear expectation on the amount and timing of that release. As detailed in the prior chapter, MFNP should develop a quarterly cash allocation plan that essentially becomes the short-term implementation agreement for the budget estimates. Whatever modifications in the budget—whether supplemental appropriations or sequestrations—can be reflected in the cash allocation plan. But whatever the amounts in the plan, they should serve as the upper limits for how much line ministries can commit to during the quarter. So for example, if the plan provides for a ministry to receive K50 million per month from January to March, then as of January 1st they may enter into commitments totaling K150 million. Notwithstanding the commitment amount, the actual delivery of the goods or services might be more staggered during the quarter to take into account the fact that cash releases needed to make payment still occur monthly.

Monitoring and Enforcement: It is not unusual for Zambia to have good regulations/policies and poor compliance with them. To remedy this, it will be important for MFNP to maintain good and timely information on commitments and to enforce its policies limiting them to a pre-specified amount. A reinvigorated Expenditure Monitoring Unit (EMU) should be responsible for monitoring the receipt and accuracy of the monthly expenditure reports from line ministries. The EMU should also be responsible for presenting a summary report to the Secretary to the Treasury each month detailing where overcommitments have occurred and/or where reporting has been inadequate to determine overcommitments.

Effective enforcement of policies and procedures is the second critical step. Where commitments exceed the allowable limit, MFNP must be more aggressive in investigating the reasons, and where overcommitment is persistently unjustified, it should take action to sanction the ministry and/or controlling officer. If the obligations of a ministry are such that it will require more than is allocated in the plan, then this should be addressed at the moment the quarterly plan is formulated and approved. Likewise, virements between subheads would require prior written approval from the Secretary to the Treasury. Or if there are legitimate emergencies these should be addressed up front, with appropriate Cabinet and/or Parliamentary authorization.

Budget Preparation: Where approved budgets have been unrealistic and failed to take into consideration the ongoing obligations or fixed costs of a ministry, it is inevitable that this will put pressure on commitment ceilings. The structural overcommitments in the budget—discussed in detail in the budget preparation chapter of this report—will not be solved overnight. Yet, MFNP can still do more to reconcile ongoing commitments with budget amounts. For example, where there is under-budgeting this should be followed by amendments to the budget, and the commitment ceilings should be adjusted subsequently—upward for some ministries and downward for others.

Capital Project Management: As was noted earlier, some arrears accumulate in the context of investment projects because there is a lack of coordination between the physical progress on projects and the payment process. MFNP and the various departments of Ministry of Works and Supply need to coordinate to ensure that there is timely payment of contractual obligations. Some responsibility lies with MFNP and can be improved once MFNP begins a serious effort at cash planning as discussed in the preceding chapter. However, within Ministry of Works and Supply there must also be better coordination between those responsible for management of the contracts and those responsible for payment. It should be noted that this coordination has recently begun to improve as a result of implementation of a commitment control system. The Bank's CFAA work in other countries has shown that there are often incentives for government officials to collude with suppliers to create arrears and the accompanying payment penalties. Although there is no evidence to indicate whether this occurs in Zambia or not, it is critical that the authorities take steps to establish firm policies on the management and payment of contracts in order to close any loopholes that may exist.

Possible Action Steps:

(a) Continue to enhance implementation of the commitment control system (CCS) so that commitment requisitions are submitted, approved, and recorded in an expenditure ledger before payments can be authorized.

(b) Develop credible quarterly cash allocation plans, and establish a policy that commitments by line ministries will be strictly limited to the quarterly amounts found in those plans. The EMU should be responsible for verifying this through the monthly expenditure returns and providing analysis to the ST on overcommitment levels.

(c) Take action to sanction ministries and/or controlling officers that persistently overcommit.

(d) Include in system requirements for IFMIS features that prevent payments from being issued without prior commitment and verification. The system should also set limits on the level of commitments.

(e) As discussed in Chapter 4, begin developing budgets that are more realistic, and that take into consideration the on-going cost structure of line ministries.
(f) Establish a procedure whereby commitment ceilings are adjusted to take into account supplemental appropriations and sequestrations that occur during the year.
(g) MFNP should establish a quarterly cash allocation plan that explicitly takes into consideration the contractual obligations that are likely to come due on investment projects during the period (See Chapter 4).

Payroll Controls

Because of the sheer magnitude of the budget devoted to personnel expenditures, they represent a significant area of financial risk if not managed well. In 2001, 37.5 percent of budget releases were for personal emoluments (K907 billion). The areas of concern within payroll expenditures basically are of two types. First, there are management and control issues that are associated with the actual transfer of funds to pay individual civil servants across the country, that is, how people receive their pay and whether the funds actually reach them. The second area is more upstream, and concerns management and control of the personnel registry to ensure that it is accurate and that only current employees are targeted to be paid.

Analysis of the Problem

Payment of Personnel Emoluments. For a country with a relatively large landmass, and a relatively sparsely populated countryside, there are some specific challenges that arise for making sure that payments reach individuals. Zambia's financial administrative network covers an area of some 750,000 square kilometers broken up into 9 provinces and 72 districts. The farthest provincial capital from Lusaka is approximately 1,100 kilometers, a 12-hour drive. In some districts, there is not access to all of the schools and health posts year round. A key element in the implementation of Zambia's payroll controls is the use of bank accounts to transfer funds and to effect payments. However, out of the 72 Districts that form the financial administration network, 26 districts do not have any banks. One consequence of not all districts having bank accounts is that some ministries make payroll payments in cash.

For employees working in provinces, MFNP releases cash directly to the provincial headquarters. The mechanism for making the transfers is based upon depositing consolidated sums in banks located in the provincial capital and having the bank facilitate the transfer to the district bank branches. The deposits are accompanied by payroll schedules prepared by the Data Centre (a unit of the Ministry of Finance). On this basis the bank transfers the salaries and allowances to the corresponding staff bank accounts. Of course, as noted above not all districts have banks, and consequently not all staff members have bank accounts.[32] In such cases, the salaries and allowances are thus cashed by a designated person

32. The Ministry of Agriculture transfers all personal emoluments directly into bank accounts, which requires that some of its staff have to travel long distances to collect their salaries. Apart from the high cost this introduces for employees because of the large distances involved, it also negatively impacts productivity as staff take off work time to pick up their salaries. In the case of the Ministry of Education, payroll is collected in cash by a representative in those districts without bank accounts.

at the district and passed on to staff members. While this mechanism may not be problematic in and of itself, when coupled with inappropriate reporting controls and audits it may serve to encourage delay in reporting the termination of a given staff member.

The challenges in executing PE payments are not limited to these 26 districts. Even though most of the 5,000 pay points within the Ministry of Education are located in Districts with banks, some of those would be still be far enough from a bank to justify the adoption of cash payroll releases.

Monitoring and Control of Payroll. Regardless of whether PE payments are made in cash or through the banking system, there must be an ongoing and effective system of monitoring and reporting of who has been paid. This is not currently the case in Zambia. While the Data Centre provides payroll listings segregated by pay point, these are distributed only to the provinces. Consequently, payroll unit heads (senior officers at the level of a pay point) have no way of ascertaining who of the staff within their unit received salaries for a given month. A staff member, having left without notice, could well continue to receive salaries without the payroll unit head being aware of it. Interviews with several line ministries, however, indicated that there is nothing that would prevent the distribution of payroll lists to the pay point and that this could be implemented immediately.

The existing methods of monitoring PE releases are ineffective in providing sufficient controls. For example, the monthly expenditure returns, with respect to the salaries, is merely a measure of releases, determined as a sum of the headquarters and provinces releases, rather than an accounting determination of the actual expenditures made out to staff. A review of some monthly expenditure returns showed flat releases each month to the line ministries. This is counter intuitive because for thousands of staff in a given line ministries one would expect that terminations (retirements, death, resignations, terminations without notice, new hiring) will result in fluctuating monthly payroll expenditures. A flat release per month suggests that payroll releases are not informed by actual expenditure.[33]

Other reports, such as the monthly allowance requests and the Deviation Report, also fail to provide safeguards against "ghosts" or on unreported separations, which potentially constitute a major source of loss. The latter, for example, focuses on flagging substantial deviations in individual pay level and even this is limited in effectiveness by the complex and extensive system of allowances, which make such variations a frequent occurrence. Monthly staff returns are submitted (sometimes only quarterly) by the Human Resources Departments, but often too late to be useful as a reconciliation document for accounting purposes.

The Data Centre, which is responsible for running the payroll, uses the Master Personnel Database File as a control file for payroll expenditure. The level of inaccuracy of the Master Personnel Database File, in terms of reflecting precisely the staff strength, directly impacts the level of losses in payroll expenditures. Accuracy is not merely a function of well-designed, fully secure software, but also of ongoing (monthly or at least quarterly) full assessments of the staffing strengths i.e., a confirmation that the payroll list reflects all the active personnel, and only the active personnel.

33. In interviews with line ministry staff they suggested that the flat payroll releases observed from month to month occurs because while the salary component does fluctuate the allowance which are in arrears far exceed the excess of release over salary. Consequently the excess always goes to fund allowances. This suggestion that monthly allowances are only partially paid brings into question the very mechanism for paying and accounting for allowances and suggests that this is an area which requires further investigation.

One of the ways "ghosts" may be introduced is through inefficient recording of personnel separations so that payments continue long after the person has ended their services with the Government. When terminations, study leave, retirements, deaths occur they are supposed to be reported through a chain via the district administration, provincial administration, and finally to the ministry's headquarters. Prior to deletion of such a record off the payroll, the ministry's headquarters (or sometimes staff from the Data Centre) must first have the deletion approved by the Public Service Management Division. While this is a critical control step, the ad hoc nature of reporting separations make applications for approvals come up on an ad hoc basis rather than as part of a structured process anticipating 400 to 1,000 separation approvals per month, which adds further to delays. Given some of the challenges outlined earlier with regards to the financial administrative network in Zambia and the number of personnel in some of the line ministries, it is the inability to perform regular ongoing full assessments of staffing strengths that contributes to substantial payroll losses.

One of the controls implemented by the Accountant General is to request for all banks to provide to line ministries lists of civil servants whose accounts have remained inactive for two consecutive months.[34] In one example, a letter from the local bank branch to the Provincial Education requests that the ministry stop transferring salaries to a list of ten names who are either deceased or do not maintain accounts with the bank. What is revealing about this letter is that the notification of termination through death is more efficient through the bank than through the internal payroll reporting system of the Ministry of Education. This is despite the fact that the ministry pays burial costs, giving families an incentive to notify the ministry in case of death. In addition, the letter reveals that there are errors in the direct transfer of funds to bank accounts since it points out that some of the names listed do not maintain accounts with the bank. In all probability, the deficiencies identified in this review are present throughout all of the line ministries.

Currently, the payroll management system may be described as passive, in that the management system awaits notification in the case of employee separation or transfer. It has assumed a posture of "no news is good news," if there are no reports of separation then there must be no separation. It assumes that controlling officers can and do check the number of active employees against the establishment register. But we note that the controlling officer without access to payroll lists cannot check the number of people paid against the establishment record. In the current system, the Controlling Officer has no basis to operate the establishment control.

The internal audit process of using head counts to check on the presence of "ghost workers" is hampered by having too few staff for an effective sample. For example in the case of the Ministry of Education, currently with only four internal auditors assigned to the provinces to cover all internal audit assignments, and with over 5,000 pay points, it is unlikely that more than 1 percent or 2 percent of the pay points can be audited each year. That level of audit sampling rate provides little disincentive to persons determined to fraudulently milk the payroll system. The internal audit process is further hampered by the lack of up to date information on the employment status at different pay points. Making a

34. Of course, such a control is irrelevant to employees who arrange to continue to have withdrawals made. Nor does it impact those who are paid in cash.

proper reconciliation of head counts with payroll lists is made extremely difficult if such payroll lists are inaccurate and outdated.

The current practice of relying on the banks for implementing expenditure controls ought not be considered a key control. While cooperation from the banks is critical in maintaining the control, such cooperation cannot be made a substitute for direct payroll expenditure controls.

Future Action Plan

The number of transactions (109,000) and the financial administrative network bottlenecks constitute a formidable challenge to effecting releases that are truly reflective of the employment services procured by the government. The aggregate releases to the provincial level currently in practice in Zambia, without proper timely feed back on actual expenditures of these releases, assures a continual hemorrhaging of government resources in paying staff (who are no longer employed). It is important to recognize that this problem cannot be eradicated by undertaking a one time national head count. The source of hemorrhaging is rooted in a poor system of monitoring and reporting coupled with an inefficient reporting system of staff who have separated, especially those who leave without notice. Therefore, given its systemic dimension, even after a successful one time massive nationwide “ghost” removal effort the problem would reemerge over time.

There are three principal recommendations:

(a) To ensure responsibility for checking and confirming the reconciliation between payroll lists (by pay point) and the people actually working on a regular basis, the senior pay point officer should be required to check and sign off on the payroll lists each month and return them to the provincial headquarters. These verified payroll lists would serve as the basis for preparing deletion and transfer lists to be submitted to the Data Center, after endorsement from the Human Resources Department, in order to update the payroll master file. This step would require information flows in a reverse direction over the financial administration network. It is apparent that information could flow well in both directions between the provinces and the headquarters; but is not obvious that reverse information flows between the pay points and the provincial headquarters on a regular and ongoing basis is currently feasible. Prior to implementing such a monitoring scheme, it shall be necessary to assess the feasibility of submitting these signed payroll lists from all the pay points to the provincial headquarters.

(b) Use the signed lists above as the basis for performing internal audits. It would immediately facilitate holding the pay point senior officer responsible for any discrepancies found between head counts and signed payroll lists. The level of accuracy would also permit reliable inferences on staff transfers, which is currently often the presumed excuse for head count discrepancies.

(c) Currently, is no direct establishment register control in Zambia. It is presumed that controlling officers will manually check and ensure that the employees do not exceed the establishment register. In practice though, the controlling officer does not have access to accurate, ongoing information on the precise status of payroll lists to make such a check. It is recommended that specific posts with unique identifying codes be developed for each and every single post within the ministry as a way of implementing the establishment register as a control directly into the payroll master database. The budgetary process would include the approval of these specific posts, which would then be filled. Consequently, no new hires could be paid against a specific post while an existing post is still being paid. This would ensure that the terminated employee would have to be taken off the payroll before a new one could be put in and in so doing would prevent the continual payroll upwards creep observed in Zambia. The creation of new posts would have to be highly controlled and only permitted as part of the budget preparation process.

Capital Expenditure Controls

Earlier sections discussed the problems in commitment control and arrears build-up in general, as well as the specific contribution that capital expenditures make to that. This section examines in greater depth some of the characteristics of financial management for capital expenditures, and highlights how they may impact the overall efficiency and effectiveness of those expenditures. What is relevant here are the nature of the contracts, the amount of information and reporting that takes place, the physical verification, and the management of payments. In summary, it was observed that the structure of the contracts themselves coupled with the lack of rigorous record keeping and management has significant financial penalties for Zambia. Cash management is highly detached from the commitment process and important information needed to inform the cash management process is often missing. Budgets themselves are unrealistic for the level of resources that are needed or actually released. Without better information management, stronger internal audit, and aggressive cash management approaches, capital expenditures will continue to suffer from inefficiency losses.

Analysis of the Problem

Government experiences financial losses on capital projects when it pays more than it should or when work is not completed to the standards agreed to. While much of capital spending is managed directly by donors through independent project units, a significant portion of capital works is nevertheless funded by government. In 2001, budget releases for capital projects totaled K300 billion (or 12 percent of all releases). Although only a small portion of the total budget, what makes capital projects a concern for fiduciary purposes is that the magnitude of the losses on any given project can be quite significant. Some estimate that capital projects in Zambia may be costing twice as much as they should.

Two central problems faced with capital projects is that budget releases are insufficient for the Ministry of Works and Supply (MWS) to cover the obligations the Government has incurred, and the lack of comprehensive and transparent accounting inhibits a careful prioritization of cash needs. Moreover, the structure of the contracts is such that if not managed aggressively the overall costs can skyrocket. There are several contributing factors.

First, the existing pipeline of projects tends to have annual costs that exceed the amount that is budgeted by MFNP. According to MWS, even if there were no new projects added (and there are a few) the budget allocations would be insufficient to cover the work envisioned during the year by the project schedules. Consequently, MWS has to decide how to slow down progress on projects in order to fit within the available resources. Obviously, there are limits to how much a particular project can be slowed before it becomes very inefficient and wasteful. MWS indicates that in some cases, only enough money is budgeted for the advance payment to be made, but not for any work. The scarcity of budget resources places an ever-greater importance on careful project prioritization. In other words, budget allocations themselves need to be informed by the specific structure of the project and whether work can be slowed in a way that makes the project still economically viable. It is not apparent that this is always the case in the current budget preparation process between MFNP and MWS.

Secondly, as stressed earlier, budget releases often vary significantly from budget estimates, and domestic capital expenditures tend to be one of the lower priorities during the year. As a result MWS may accumulate arrears or work may not be performed as was scheduled. Because of the exploding level of arrears, the interest costs can be quite high. MWS has also said that the break down between contract payment and interest is approximately in a 1:1 ratio. For some projects, Government is only making interest payments and not payments on the principal.

An important question is how the cash releases for individual projects are determined, and whether the process can be managed in a way that minimizes the impact on aggregate project costs. Under the current system, MFNP decides on cash releases to MWS with incomplete information to make economically optimal decisions. MWS sends to MFNP reports on the outstanding amounts due on projects, but other vital information are lacking. MFNP decisions should be informed by the amount of current charges versus arrears so that an appreciation may be made of the potential interest cost and penalties of late payment. MFNP should also be able to know the upcoming cash needs for projects and the relative priorities as indicated by MWS. In some cases, contractors have opted to go directly to MFNP for securing payment so that when MWS receives a release, it is earmarked to that specific contractor. As a result, other needs which may have been of greater urgency, get delayed.

Some of the challenges in developing cash flow forecasts are consequences of the information flows within the MWS. While MFNP obtains copies of contracts that have been signed, the financial management units (FMU) within the line ministry are often unaware that such contracts have been entered into until the first request for payments of interim certificates is made. Within the line ministry, the project engineer typically keeps the copy of the contract, and hence there is no centralized repository to reference the financial elements of a contract and to ensure that the FMU has a comprehensive listing and up to date status of all of the capital expenditure contracts and variations. Thus, financial management within MWS is limited to the monitoring of payments of interim certificates with no broader perspective on the outstanding contract works, rate of work completion. Hence, they have absolutely no basis for preparing pro forma cash flows, or assessing the impact of inflation, currency fluctuations, or late payments. Further, there is only a limited basis upon which to apply controls for claims on price variations or late payment penalties, since the FMU is often unaware of the full terms of the contracts.

The contracts themselves are structured in such a way that unless the FMU is carefully monitoring, there may be opportunities for abuse and for substantial overpayment. Typical capital expenditure contract includes clauses for:

- Contract works variations (not to exceed 25 percent of the total value of the contract);
- Price variations, which in an inflationary environment typically exceed 20 percent;
- Currency rate fluctuation variations; and
- Late payment penalties, which are applied at commercial bank interest rates. These are currently at 45 percent, thus this factor very quickly becomes a significant component of capital expenditure.

The fact that Zambia incorporates both price variation clauses and foreign exchange clauses may be permitting some contractors to be overcompensated when price fluctuations are linked with foreign exchange rate changes. Moreover, by allowing price fluctuations to be awarded on a discretionary basis may open a window for abuse.

Finally, the monitoring and evaluation of the physical progress is also important to preventing financial loss. However, the internal audit department of the Ministry of Works and Supplies, with four auditors responsible for well over 100 projects, is understaffed to perform meaningful materiality audits of the projects. Without any engineers assigned to the units, it is unlikely that any independent checks beyond the input from the project engineer on-site is achieved. The current level of project audits at the Ministry of Works and Supply is inadequate.

Future Action Plan

In order to address the weaknesses identified above, the following actions need to be taken:

(a) Develop a regular expenditure reporting mechanism between MWS and MFNP that segregates:
  - Principal/Original Contract Value
  - Work Variations
  - Price Variations/Currency Fluctuations
  - Late Payment Interest Penalty

Institute regular cash flow forecasting from MWS to MFNP to inform cash release decisions.

(b) Develop a database and reporting structure that distinguishes for each project:
  - Total contract value, budgeted years to completion
  - Proportion of project completed, years already undertaken
  - Proportion of project to be completed in current budget year,
  - Future outstanding contract value, number of years beyond current year to completion

(c) Review the practice of allowing both price and exchange rate variations in contracts.

(d) Ensure that the FMU maintains copies of each project contract.

(e) Reinforce the capacity of internal audit to conduct materiality audits.

Public Procurement[35]

Background

Addressing the weaknesses in budget execution and budget control will go a long way in keeping public expenditures under control and contributing to a sustainable fiscal policy. But, as the chapter on governance pointed out, Zambia needs to go beyond public expenditure management issues if it wants to restore both public confidence and the confidence of the international community in accountability. Development of a well-functioning procurement system, based on transparency, competition, economy and efficiency, fairness, and accountability is a critical step in this direction.

A Country Procurement Assessment Review (CPAR) was conducted for Zambia in January 2002 and in March 2002 by a team comprising officials from the Ministry of Finance and National Planning, a multi-disciplinary Task Force representing various concerned organizations set up by that ministry, a group of Government consultants (PLS RAMBOLL), and World Bank officials. The CPAR analyzes the existing public procurement system in Zambia and recommends suitable actions to improve the economy, efficiency, predictability, and transparency of the procurement processes. It provides Government with tools to make changes and to improve the public procurement system and institutional framework. This chapter is a summary of the key aspects of the CPAR report.

Importance of Public Procurement in Zambia. Public procurement plays an important role in the Zambian economy. The total volume of public procurement in 2001 was estimated at US$485 million, equivalent to 15 percent of GDP—this is a higher proportion than the 10 percent estimated for most countries in Africa. The Central Tender Committee (CTC) of the Zambia National Tender Board (ZNTB) processed and approved procurement valued at 12 percent of GDP while another 3 percent of GDP was procured at a decentralized level by ministries and provincial administrations. If even a conservatively estimated 10 percent of this cost could be saved through better procurement policies, practices, and institutional arrangements, this would mean a yearly gain to the exchequer on the order of US$50 million.

Analysis of the Problem

Gaps in the Public Procurement System's Intentions and Practices. A gap between intentions and practice pervades various aspects of Zambia's public procurement. Despite a legal and institutional framework, weaknesses in its structure and content allow undesirable practices and procedures. While the ZNTB is expected to enforce procurement rules, in practice, it is liberal in permitting exceptions and allowing negotiations to replace clear procurement guidelines. A system to register suppliers for small-value procurement, for example, has flaws that could engender corrupt practices. While short-lists are drafted on the basis of the registration list, each short-list is subject to misuse to favor particular firms. Further, the registration lists are not systematically updated nor are the means available to check the data applicants submit in registration forms. Moreover, the system is liberally used for larger value items than intended. The ZNTB also has a significant supervisory role, but its pre-

35. This section is a summary based on a larger report, World Bank (2002), "Zambia Country Procurement Assessment Review (CPAR)." The CPAR is issued as Annex 3 to this report.

occupation with processing procurement prevents this. The existing system for handling complaints features a too-narrow scope and design, lacks independence from the ZNTB which is involved in the procurement process, and it suffers from a perfunctory operation, causing supplier and contractor dissatisfaction to grow while malpractices continue.

The slow pace of "delegation of authority to procure" to the ministries and agencies is partly due to ZNTB's lack of confidence in their capacity. Yet, there are also other reasons for persistent lack of adequate interest in reform of public procurement. The lack of interest in ministries and agencies to actively pursue even the limited program of delegation of procurement authority is symptomatic of underlying causes such as preference for a system of diffused responsibility and accountability offered by the current lax systems and procedures and institutional arrangements. Any tightening of the arrangements would affect the distribution of rents, be it ZNTB, senior officials or politicians. Though difficult to pin down in any country, political interference in public procurement in Zambia is generally acknowledged.

This situation, combining poor legislation and procurement practices with political interference and untrained procurement staff, fosters corrupt practices. Though the government had not initiated (until September 2002) a survey on corruption financed by the World Bank some time ago, the CPAR noted a common perception in Zambia that substantial corruption is associated with public procurement. Yet, the Anti-Corruption Commission (ACC) and the OAG, which have roles to play in curtailing corruption, have been hampered by funding and little effective attention to their reports.

Legal and Institutional Weaknesses. The legal framework[36] lacks robustness and features structural, and content, inadequacies. Basic principles of procurement are not captured comprehensively. Further, aspects that should be in the Act are in the regulations or guidelines and vice versa. The ZNTB's role is not limited to oversight and policy functions, as it also must manage public procurement through CTC. Among the neglected oversight functions include: (i) monitoring and gathering statistics on public procurement, (ii) developing procurement capacities and capabilities, and (iii) implementing public procurement reform.

Weaknesses in Procurement Procedures and Practices. Two current practices also foster corruption and higher prices: using negotiations as an accepted procurement method and misusing the registration system for purchases from short-listed firms. Further, the ZNTB's capacity to resist ministry pressure promotes acceptance of less cost-efficient and corruption-prone procurement methods. Additionally, relatively low thresholds (US$300,000 maximum for ministries in the highest category for decentralization through "delegation of authority to procure") lead to more costly procured goods and civil works. These low thresholds cause ministries to split contracts into smaller sizes to avoid ZNTB involvement. The registration system is then used to buy items beyond the monetary threshold for the registration normally permits.

Weaknesses in Procurement Management. In the few departments where they do exist, procurement files are often incomplete. Also, there are no instructions on how to structure an official procurement filing system and to maintain individual files. Without a

36. The legal framework is mainly based on the 1982 Zambia National Tender Board Act (ZTBA), which has limited scope and unclear enforcement mechanisms. It provides for the establishment of the Zambia National Tender Board (ZNTB).

proper filing system, supporting papers (such as performance guarantees) are inadequate for good contract management. Poor contract management produces avoidable losses to government. Also, procurement planning as a tool for conducting efficient and economic procurement is largely non-existent. Vital aspects of procurement planning (packaging, selecting appropriate procurement method and type of contract) are not planned early in the procurement process. Inevitably, substantial delays in processing and inefficient "urgent" procurement actions result.

Inadequacies in Budget Allocation and Funds Release System. As discussed in the Chapter on budget execution, due to the cash budget system, the funds allocated in the budget for each project and each ministry often are not fully released during the year[37], and there are significant delays in the release of small amounts. This seriously affects efficient project implementation, procurement, and contract management. Consequences of the budget system's weaknesses include: (i) contractors' bills being held up for several months, delaying projects; (ii) delayed payments incurring interest charges that are paid from a ministry's limited budget, further reducing funds for product payments, and (iii) when contracts designated in foreign currencies have protracted payment delays, exchange rate changes cause larger amounts of local currency to be needed than originally planned. All this contributes to higher procurement costs and avoidable losses to government.

Procurement Cadre. Even though a well-trained procurement cadre is crucial to efficient procurement, there has been no progress in efforts to set up such a cadre. Over 600 people have been trained in procurement at different levels, but most have left their jobs, leaving untrained people in many positions. Trained staff leave because of the lack of a career path, an unattractive salary structure, etc. ZNTB salaries are even lower than the Zambia Revenue Authority's. The ZNTB's staff and those in the ministries do not have defined career paths or a department responsible for managing the cadre and its capacity development.

Capacity Building. Procurement training institutions[38] exist, but need to upgrade their offerings to feature mid-career and specialized procurement training programs to supplement the supply management programs they currently conduct

Anti-Corruption Commission (ACC) and OAG Handicapped by Insufficient Funding and Salaries. The activities of the Anti-Corruption Commission and OAG are critical if Zambia is to achieve a well-functioning, fair, and transparent procurement framework. Though the President acted recently to strengthen the ACC to fight corruption by creating a special cell whose role would also include procurement issues, unattractive salaries and conditions of service hamper its ability to attract and retain skilled personnel. OAG is also underfunded and its reports remain inadequately acted upon.

Actions Taken to Date

Assistance to Procurement Reform. Reform of the public procurement system has been on the Zambian Government's agenda for almost a decade. This goal has resulted in a number of donor-funded projects, which have supported, and continue to support, the Government's

37. The practice of allocating a "nominal" 1 Kwacha for "tentative" projects further strains the budget for other projects when more than the allocated 1 Kwacha is finally released to such projects.

38. For example, the Zambian Institute of Management (ZAMIM) and Zambia Insurance Business College Trust (ZBIC).

public procurement reform agenda. In 1993, the World Bank and the Zambian government agreed on a Financial and Legal Management Upgrading Project (FILMUP), which among other things, focused on improving the Zambian National Tender Board's and various ministries' procurement performance. In the mid-1990s, SIDA provided support for training and capacity building for improved public procurement. In ESAC II (the second Economic and Social Adjustment Credit), strengthening and streamlining public procurement was an important element. The Public Service Capacity Building Project (PSCAP), which is currently being implemented, seeks to strengthen the Office of the Auditor General and the ZNTB in their roles of ensuring sound management of public funds.

Government Action. In 1996, the Zambian government adopted the Public Procurement Action Plan (1996), which aimed to develop the human resources of the public procurement system along with decentralizing procurement to various ministries and agencies and strengthening audit and oversight functions. In 1997, a World Bank Country Procurement Assessment Review concluded that the action plan implementation had moved more slowly than expected, particularly with regard to the planned decentralization (through "delegation of authority to procure") and the establishment of a cadre of procurement professionals to support improved procurement activities. The current report concludes that, in many respects, the objectives of the 1996 action plan still have not been realized. A number of steps have been taken, but in significant areas, required reforms have not been implemented effectively, or reform results have not been lasting or have been otherwise insufficient.[39]

The current CPAR concludes that the 1996 Action Plan's overall objectives have still not been realized, inter alia, due to insufficient efforts by ZNTB. Though a number of steps were initiated, planned reforms in significant areas have not been efficiently implemented:

- *Improvement of procurement capacity in the Procurement and Supply Units (PSUs) has been slow.* In the 1996 action plan, setting up the procurement cadre emerged as a crucial step for decentralizing procurement to PSUs. The cadre needs a defined career path and an attractive salary structure linked with a well-developed training system. These improvements were not initiated and the cadre was not created. The capacity in the PSUs remains a problem except where ZNTB has seconded its staff to work in some ministries' PSUs.
- *Implementation of the Action Plan (1996) did not get adequate attention.* Examples are: (i) little or no progress in decentralization[40] over 6 years, as the ZNTB did not give a single ministry full authority to conduct its own procurement, (ii) partly because a procurement cadre was not created, procurement capacity building[41] was unsustainable, as recently trained staff left for other jobs. Preoccupied with managing procurement, the ZNTB did not focus on the 1996 Action Plan.

39. However, the election of a new political leadership in Zambia in December 2001, who appear determined to fight corruption, may open up new possibilities for the efficient implementation of reforms

40. Full decentralization of procurement for all PSUs by 2002 did not materialize. Of 51 PSUs, 24 are not yet certified; the monetary thresholds for the remaining 27 are very low. The ZNTB is still involved in processing 80 percent of procurement.

41. Professional procurement staff is required to support decentralized procurement. Where the ZNTB has seconded its staff to ministries to operate decentralized procurement units, PSUs procurement capacity is better.

Drafting of a Strategic Plan. Presently, in coordination with AfDB, the ZNTB has drafted a Strategic Plan (2002–2006) that envisages minor adjustments to legislation and decentralization limited to "certifying" all 51 PSUs over time, but not authorizing them to do all their own procurement. The strategy, coverage, and content of this draft Strategic Plan could be enhanced as a result of the current CPAR.

Future Action Plans

Central to any recommendations that emerge is the need for a "champion" for the Reform program as it should not be left to be an internal program within ZNTB. Besides, such a program that needs to tackle the various vested interests in the status quo can only be tackled by political will.

Given adequate attention to the above, the actions described below are priorities for improving the Zambian public procurement system. (See also the fully developed action plan in the ACTION PLAN MATRIX in annex at the end of this report).

- *(i) Establish a Procurement Reform Task Force (High Level Committee).* Set up a High Level Committee that will be responsible for initiating and overseeing implementation of activities in the action plan developed by this CPAR. This Committee must have high-level members from, for example, ZNTB, MOFNP, ACC, and OAG, and members should not be allowed to appoint substitutes. The Committee should have a clear mandate and time frame for concluding its reform agenda. A Procurement Reform Implementation Unit (PRIU) should be created to manage day-to-day implementation of reforms and to act as the secretariat to the Task Force. This Unit should be separate from the ZNTB and should report to the Permanent Secretary in the Ministry of Finance.
- *(ii) Re-establish the Policy and Supervisory Role of ZNTB Immediately.* Without waiting for new procurement legislation (see below), refocus ZNTB to its policy and regulatory role already required under existing legislation. As the ZNTB Director General will manage the CTC until its dissolution in 3 years (see below), strengthen the secretariat of ZNTB to support it in this role by enhanced staffing (and possibly splitting it off from the current secretariat). Provide an adequate budget to support this objective.
- *(iii) Revise the Legal Framework.*[42] Ideally, a new procurement act whose content should be guided by the UNCITRAL Model Law and by current international best practices. Among other things, it should provide for a new procurement authority and a complaints system based in the procurement authority but with a separate, independent, part-time Appeals Body. A Cabinet Paper should be developed for the new legislation, which Parliament should enact. New regulations and guidelines should be developed on the basis of the new act. Pursuant to its enactment, a new procurement authority should be established. A Director General

42. The Terms of Reference(TOR) for the review of the legal and institutional framework, which is currently being developed with the AfDB, should be revised to consider the recommendations of the present report. The TOR should state clearly that revisions of procurement legislation should build on the UNCITRAL Model Law.

and other staff for the new authority should be appointed to replace the ZNTB immediately on creation of the Authority. The Authority's specialized functions should be described and developed in detail.

(iv) *Finalize the Plan for gradual delegation of procurement authority.* A phased, 3-year plan for delegation of procurement authority should be developed. The plan would give full authority to ministries and agencies to conduct procurement without reference to or approval by the ZNTB or CTC. In the short term, the plan should appoint one or two provinces as pilot provinces for full decentralization. In the long-term, upon full decentralization, CTC would cease to exist. Implementation of decentralized procurement, however, is contingent upon there being a strong accountability system in place, which would include use of sanctions by MFNP for violators. Implementation is also dependent upon adequate capacity at PSUs.

(v) *Establish a Professional Procurement Cadre.* Define the composition of the cadre to be established and supporting measures, including funding an adequately attractive salary structure. Start implementing such measures giving the cadre management function to the ZNTB until the new procurement authority (possibly called Zambian National Procurement Authority or ZNPA) comes into effect. The existing system of secondment of ZNTB staff to positions in PSUs directly managed by the ministries and agencies should apply for all the staff in the procurement cadre. A human resource database should be established with both cadre members' curriculum vitae and those applying for membership. A training action plan should be developed.

(vi) *Re-design Registration List System.* A revised Registration System should be defined. New guidelines should be developed that restrict its use to small-value contracts only.

(v) *Anti-Corruption Actions.* The planned corruption survey (begun in October 2002) should be implemented quickly. Implementation should be coordinated with the Public Service Capacity Building Project (PSCAP). Anti-corruption clauses should be included in the standard bidding documents.

(vi) *Introduce Procurement Planning and a New Filing System.* A manual on procurement planning should be developed, containing clear instructions for introduction of best practices. Release of budget funds from the budgetary system should be suitably linked to realistic procurement plans. A separate procurement register should be defined. In addition, instructions and guidelines should be developed for PSUs on establishing and maintaining a procurement filing system.

(vii) *Strengthen Training Programs and Training Institutions.* A capacity assessment of training institutions should be carried out. The need for supplementary procurement training programs should be defined. Required training programs should be developed and delivered.

CHAPTER 6

Accounting, Reporting, and Audit

This chapter has two sections. The first section will examine Zambia's current system as well as capacity to provide timely, accurate, and ongoing reporting of expenditures. It examines the current obstacles to reporting at central and line ministry levels, highlights reforms that have been carried out to date, and proposes measures which could be taken to address the remaining problems, including the implementation of the Integrated Financial Management and Information System (IFMIS) as a medium to long-term option. The second section addresses budget auditing issues. It examines the institutional roles and relationships for the conduct of internal and external audit, highlights the weaknesses that exist in internal and external audit, and lays out the progress made over the past few years and what remains to be done in the future.

Legal Basis for Accounting and Reporting

The Zambian Constitution defines[43] the content of the annual reports. The Subsidiary Legislation to the Finance Act and the Procedures Manual dated 1992 describe in detail accounting procedures and provide ample guidance to government agencies and officers:

- A cash-based accounting system with simple ledgers for recording of commitments and expenditures is prescribed. Commitments are to be recorded when created and

43. Article 118 of the constitution prescribes that (1) the MOF (minister) shall cause to be prepared and shall lay before the National Asembly not later than *nine months after the end of each FY* a financial report in respect of that year. (2) The financial report shall include accounts showing *the revenue* and other moneys received by the government in that FY, *the expenditure* of the government in that FY other than expenditure charged by the constitution or any law on the general revenue, *the payments* made in the FY otherwise than for the purpose of expenditure, *a statement* of the financial position of the republic at the end of the FY and such other information as parliament may prescribe.

expenditures recorded (in a separate column) when payments are made. Monthly returns are to be produced from the books.

- Monthly reconciliation of bank accounts is required.
- Stores and assets management remain the responsibility of the COs.
- Checkbooks and issued checks are to be under the custody of the Accounts Departments of each spending agency, and issued checks are not to leave the department unless proof of delivery of goods and services has been provided.
- Each CO is required to provide to the MFNP monthly returns and any other information as the PS-MFNP may instruct the agencies. Controlling officers must produce monthly returns for the Accountant General within 15 days after the end of each month. The returns contain budget provision, total expenditure, outstanding commitments, total actual releases (including appropriations-in-aid), and arrears.
- The monthly returns are to be accompanied by bank reconciliation statements.

The legislation, however, is totally silent on the role and responsibilities of the Accountant General. The functions currently performed by the Accountant General are part of the responsibilities assigned to the MFNP generally. Nevertheless, if fully observed, the existing provisions are adequate to ensure that proper accounting and financial data are maintained.

The Current System for Financial Management and Reporting

Overall the systems used by MFNP for financial management tend to be either manual or rely on outdated technology with limited applications. Budget preparation, budget execution, and payroll management are all separate and independent applications within MFNP that do not interact with each other. In line ministries the situation is generally worse, with reliance upon basic spreadsheet applications where available. There are few personal computers available within MFNP (that are in working condition) and many of those are also outdated. Fifty personal computers were recently received and have been distributed for use throughout the GRZ. However, training on the new computers and networking of these computers will be necessary before they are fully functional.

Budget preparation tends to be done through an in-house system called Computer-Aided Budgeting (CAB), which is used for consolidation of line ministry estimates and eventual production of the budget document itself.[44] The line ministries generally do not have access to this software, but instead either submit documents in hardcopy or on a diskette. Budget releases are managed separately and are not part of the CAB.

The accounting function is heavily reliant upon manual record-keeping, especially in the line ministries. Line ministries and provinces submit their monthly expenditure reports on diskette to MFNP with the help of a computer-based Financial Management System (FMS). The IMF has noted in its report that the FMS is “mainly a data-capturing application with few utilities and limited reporting functionality.” The FMS records the details of transactions after the payments have been made. The MFNP data center consolidates the reports of the various units using a Government Accounts (GA) application, though the IMF has noted that there is usually considerable time lag between entering the data and its

44. See IMF (2001) report on public expenditure management in Zambia.

eventual consolidation. During the Bank's initial PER mission in 1999, the Accountant General's office also cited the extremely limited analytical and reporting capacity of the MFNP's COBOL-based computing system.

Payroll is managed in a slightly different manner, although the actual transactions are also recorded in the FMS by MFNP. Cabinet Offices maintain the establishment register and personnel records based on manual updates received from line ministries and provinces. The Data Center processes the updated payroll lists and transmits them to the line ministries to execute payments. After check issuance, the payroll payments "are entered in the FMS system in the same way as non-wage expenditures." The weaknesses in these procedures have been recognized, and a Human Resources System is currently being developed with implementation planned in 2003.

Analysis of the Problem

There are two dimensions to the problems of financial reporting in Zambia: (i) problems related to recording, accounting, and reporting; and (ii) problems with regard to the timeliness and accuracy of financial reports. Each is discussed in turn. The observations are based on the procedures and processes in place through the first half of 2002. At that point, new software was introduced for expenditure and commitment by line ministries. As discussed later, this may make possible more accurate reporting in the future. Until then, some of the deficiencies described below may still remain.

Accounting and Reporting

In exercising the powers conferred on the COs, officers in the ministries and provincial departments commit and spend and issue vouchers for payment. According to the formal rules, vouchers are issued by the spending unit and sent to the Accounts Department for recording and payment. The vouchers are used to record both the commitment and expenditure in the expenditure control ledger/cash book. The practice is, however, different.

First, in some restructured ministries, the commitment is recorded only when the check is issued and at the same time that expenditure is recorded. This represents a serious breakdown of the formal system—it undermines the distinction between commitment and expenditure, and distorts the financial information. Another departure from the prescribed rules is a practice whereby checks are issued, and handed over to the procurement staff before the delivery of goods and services.

Second, in some ministries, the relevant spending units are keeping the ledger for commitments while the accounting department keeps records of expenditures and is not involved in the commitment control process.

Third, the above described shortcuts and deviations are found in restructured units where experienced staff have been made redundant. Training for accounting staff needs to be prioritized.

Finally, Accounts Department produces accounts and monthly returns from the vouchers and their ledgers. AccG's office produces quarterly accounts and reports based on those returns. The ST can freeze a spending agency's bank account if the return is not received on time. However, the sanction has not been applied even though several ministries are systematically late in their submissions. The assistance provided by the office of the

AccG to the agencies has to some extent improved the timeliness and the quality of information. However, the quality of returns still remains uneven across government agencies.

Timeliness and Accuracy of Financial Reports

In conformity with the legislation (Article 118 of the Constitution), MFNP has to produce the Republic's Financial Report for the year and lay it before the NA within nine months after the end of each fiscal year. Before the production of consolidated accounts, the Office of the Accountant General carries out some checks and reconciliation. For this purpose, in addition to the monthly returns, each CO is required to send a copy of the cash book and a bank reconciliation statement to the MFNP.

For the first time in ten years, the audited report for FY2000 was issued before the legal due date. This is an achievement, given the capacity and system in place. However, several problems remain.

First, the bank reconciliation statements do not include the beginning and ending balances of the bank accounts. It is unclear as to how bank reconciliation can be done without those balances.[45] Possible discrepancies may arise from cancelled checks if the corresponding funds are not returned to the BoZ.[46] Likewise, without the balances it cannot be verified whether all of the released funds are actually used. Moreover, it has been noted that some agencies have used overdrafts, which are expressly forbidden without written authorization from the PS-MFNP. (See below for further discussion on reconciliation of budget releases with actual expenditures.)

Second, other weaknesses were noted with respect to the completeness and accuracy of financial information, which have implications for financial statements:

- Ledgers designed to accurately account for commitments and payments/expenditures are not used properly.
- Commitment and payment transactions are either posted at the same time—and this was sometimes done even before delivery of goods and services—or sometimes, commitments are not posted. The latter practice was observed where commitments have been created without regard for standing instructions from the MFNP.
- In case of a reorganized agency, we observed a total breakdown in segregation of duties and internal control mechanisms. The procurement unit performs incompatible tasks. These included control over the stores as well as receiving and keeping checks from accounting, in anticipation of delivery of goods and services by suppliers.

Because of these irregularities, the books of accounts are incomplete, and because the books are incomplete, the monthly returns and the subsequent financial reports based on these returns are most likely incorrect.

Third, it seems that the quarterly consolidated reports are incorrect due to omissions or double counting. While some ministries wait for information from provincial offices

45. In fact, despite the time spent in the relevant service, the mission was unable to receive full information or fully understand the bank reconciliation practice at MFNP.

46. Any check outstanding for more than six months is cancelled automatically, but it is unclear if the funds are transferred from the ministry's mirror account back to the BoZ.

and consolidate the data from provinces, others send the HQ data alone. As we understood, the unit at the MFNP waits for and consolidates all data from all 51 COs. Therefore, there is a high probability for omission or double counting. This raises the question about the end of year accounts and bank reconciliation as well. In addition, hidden vouchers are not necessarily included in the monthly returns and it is not clear if they are liquidated at the end of the FY. On the other hand, some loans to individuals and private firms are included. These need further review and analysis.

Fourth, as pointed out above, the exact roles and responsibilities of the Accountant General are not defined in the existing legislation. Functionally, the AccG who produces the Republic's accounts on behalf of the M-MFNP, has a "supervisory" role with respect to the accounting and financial information. However, he is institutionally attached to the PS-FMA and reports to him.

Fifth, quarterly and annual financial statements produced by the Office of the AccG reflect mostly transactions that flow through Control Account 99 (CA # 99). The Account is plagued with problems of reconciliation and availability of information in both inflows and outflows. The inflows are deposits from: (i) Zambia Revenue Authority (ZRA); and (ii) individuals or bodies depositing funds to the general revenue. However, the ZRA does NOT have any reporting relationship with the AccG, and therefore the AccG does not receive detailed information/explanations as to how much is deposited/ paid, by whom and why. The outflows, on the other hand, are executed by the Budget Office, which again has no formal direct relationship with the AccG. The lack of efficient and effective communication with ZRA and the Budget Office has meant that the AccG does not receive adequate information to reconcile the accounts and the Budget Office is not doing an adequate job. As a result, the consolidated accounts and aggregate statements are not reconciled. Besides the other factors mentioned above, this raises an issue regarding the completeness of the annual reports. It is worth noting that the Bank's and other donors' project resources and expenditures are not included in the Financial Statements. In addition, the financial reports contain no information on contingent liabilities.

Table 12 below provides evidence of some of the anomalies that appear in the Financial Statements. For five ministries—Agriculture, Education, Health, Local Government, and Works and Supply—it compares the budget release with the actual expenditures reported in the Financial Statements. Where the variance is positive, it indicates that releases exceeded expenditure, and it suggests that funds would have been returned to the Treasury. It is unclear though whether this occurred, or instead, whether the funds were actually used for another expenditure category, for example, PE resources used for RDCs. Even though the Financial Regulations prohibit transfers between PEs and other categories, there were ministries that acknowledged this occurred. The more curious cases are those where the variance is negative, indicating expenditures exceeded the cash release. The magnitude of the variances calls into the question the accuracy of the reporting, and underlines the importance of reconciliation needed between cash releases, expenditures, and banking data.

Recent Actions

In June 2002, MFNP implemented at the headquarters of each line ministry a Microsoft Access-based program for recording data on budget allocation, commitments, arrears, and expenditure payments. Provincial offices are expected to have the system ready by end-2002.

Table 12. Comparison of Budget Releases and Actual Expenditures

Ministry	Year	Budget Sub-Head	Budget Office Releases	Expenditure Accounts	Variance on Budget Releases Amount	%
Agriculture	1998	PE	13,906,610,261	15,736,541,397	(1,829,931,136)	–13
		RDC	12,653,798,797	14,212,076,173	(1,558,277,376)	–12
		Grants & Other	2,942,702,481	2,154,971,994	787,730,487	27
		Total	29,503,111,539	32,103,589,564	(2,600,478,025)	–9
	1999	PE	17,110,472,155	7,460,852,637	9,649,619,518	56
		RDC	6,791,364,711	12,344,303,884	(5,552,939,173)	–82
		Grants & Other	11,566,850,920	11,055,077,129	511,773,791	4
		Total	35,468,687,786	30,860,233,650	4,608,454,136	13
	2000	PE	19,983,946,291	9,290,319,684	10,693,626,607	54
		RDC	10,570,614,243	20,888,017,815	(10,317,403,572)	–98
		Grants & Other	183,900,516	308,896,647	(124,996,131)	–68
		Total	30,738,461,050	30,487,234,146	251,226,904	1
Education	1998	PE	94,300,000,000	94,650,052,371	(350,052,371)	0
		RDC	28,653,857,265	21,388,019,363	7,265,837,902	25
		Grants & Other	22,952,176,291	22,675,811,694	276,364,597	1
		Total	145,906,033,556	138,713,883,428	7,192,150,128	5
	1999	PE	122,671,168,090	109,623,566,626	13,047,601,464	11
		RDC	26,024,782,841	22,590,515,686	3,434,267,155	13
		Grants & Other	27,147,062,087	24,124,972,216	3,022,089,871	11
		Total	175,843,013,018	156,339,054,528	19,503,958,490	11
	2000	PE	155,998,180,698	135,120,969,432	20,877,211,266	13
		RDC	35,470,698,548	37,596,614,547	(2,125,915,999)	–6
		Grants & Other	36,205,112,530	32,848,455,334	3,356,657,196	9
		Total	227,673,991,776	205,566,039,313	22,107,952,463	10
Health	1998	PE	27,247,864,968	51,368,713,870	(24,120,848,902)	–88.5
		RDC	17,956,119,107	13,691,806,247	4,264,312,860	23.7
		Grants & Other	58,162,592,281	51,047,575,464	7,115,016,817	12.2
		Total	103,366,576,356	116,108,095,581	(12,741,519,225)	–12
	1999	PE	30,404,795,539	63,315,480,150	(32,910,684,611)	–108.2
		RDC	22,443,288,961	20,826,975,192	1,616,313,769	7.2
		Grants & Other	62,451,758,490	20,743,190,652	41,708,567,838	66.8
		Total	115,299,842,990	104,885,645,994	10,414,196,996	9

(*continued*)

Table 12. Comparison of Budget Releases and Actual Expenditures (*Continued*)

Ministry	Year	Budget Sub-Head	Budget Office Releases	Expenditure Accounts	Variance on Budget Releases Amount	%
	2000	PE	75,236,557,679	32,431,012,533	42,805,545,146	56.9
		RDC	26,162,597,566	32,340,497,939	(6,177,900,373)	–23.6
		Grants & Other	35,832,697,680	41,104,726,084	(5,272,028,404)	–14.7
		Total	137,231,852,925	105,876,236,556	31,355,616,369	23
Local Government	1998	PE	423,255,282	836,774,385	(413,519,103)	–97.7
		RDC	4,381,735,696	3,129,275,879	1,252,459,817	28.6
		Grants & Other	10,012,668,836	5,443,488,292	4,569,180,544	45.6
		Total	14,817,659,814	9,409,538,556	5,408,121,258	36
	1999	PE	1,111,602,165	1,016,184,041	95,418,124	8.6
		RDC	2,656,746,358	2,592,487,824	64,258,534	2.4
		Grants & Other	6,546,577,387	5,647,765,376	898,812,011	13.7
		Total	10,314,925,910	9,256,437,241	1,058,488,669	10
	2000	PE	1,608,549,697	1,472,800,020	135,749,677	8.4
		RDC	4,606,762,416	4,457,445,278	149,317,138	3.2
		Grants & Other	15,623,475,029	14,356,867,434	1,266,607,595	8.1
		Total	21,838,787,142	20,287,112,732	1,551,674,410	7
Works and Supplies	1998	PE	1,626,982,795	2,738,775,354	(1,111,792,559)	–68.3
		RDC	3,048,296,593	3,710,975,699	(662,679,106)	–21.7
		Grants & Other	225,540,167	216,521,803	9,018,364	4.0
		Total	4,900,819,555	6,666,272,856	(1,765,453,301)	–36
	1999	PE	2,976,086,603	1,938,472,022	1,037,614,581	34.9
		RDC	3,029,660,167	2,666,794,749	362,865,418	12.0
		Grants & Other	753,253,651	645,258,227	107,995,424	14.3
		Total	6,759,000,421	5,250,524,998	1,508,475,423	22
	2000	PE	2,763,410,047	2,438,828,784	324,581,263	11.7
		RDC	5,363,885,751	6,129,039,614	(765,153,863)	–14.3
		Grants & Other	1,093,467,116	919,938,293	173,528,823	15.9
		Total	9,220,762,914	9,487,806,691	(267,043,777)	–3

The source document for entering data into the system is the backing sheet that is submitted to BoZ.[47] Although the new Financial Management System (FMS) provides for entering commitments, currently these are equivalent to the payment amount because they are entered into the computer at the same time. This practice may be explained in part by the fact that Accounting is often not informed of LPOs or contracts until the time at which payment is requested. Nevertheless, despite these limitations of the system, the use of the backing sheet to key in data almost certainly increases the accuracy of the monthly expenditure reports to MFNP. It also creates an automatic reconciliation of expenditure data with the bank accounts.[48]

Future Action Plan

While the FMS and use of the backing sheets constitute important steps toward improving the reliability of expenditure reporting, further actions are still warranted.

- Modify the accounting procedures and chart of accounts in order to capture commitments and arrears and to highlight interest charges on late payments.
- Modify the FMS process to include inputs on the LPOs, contracts, and all commitment documents.
- Reconcile monthly expenditure returns with monthly releases for each unit or department that is rolled up to the ministry level.
- Restrict funding for ministries that do not submit a monthly return.
- Ensure that agency funds related to cancelled checks are returned to the BoZ promptly.
- Impose penalties for overdrafts without written authorization from the Secretary to the Treasury.
- Clarify and clearly define the role of the AccG in the legislation, so that he/she will directly report to the Minister of Finance or the ST. This shift will also improve the coordination and communications with the Budget Office.

Establish mechanisms for institutional review and vetting of any organizational restructuring. Provide specific directives to guide staff and strengthen staff training on internal controls, especially for restructured institutions so that the control framework remains intact.

Moving Towards Integrated Financial Management Information System (IFMIS)

Need for IFMIS

Few will argue with the inadequacy of the current information systems at MFNP to provide reliable control of and reporting on public expenditures. As pointed out above, the current

47. The backing sheet is the list of checks that the Ministry is issuing and serves to inform BoZ of the amount that should be transferred to the Ministry's mirror accounts to cover the checks.

48. Reconciliation is still needed to account for checks that may not have cleared or additional funds that were deposited.

systems produce a number of serious problems that must be addressed. First, expenditure reports are prone to errors and inconsistency that are difficult to find and to reconcile under the current system. Second, reporting tends to be significantly delayed because of the various levels of compilation required. Third, the focus on bookkeeping tasks distracts accounting staff from more meaningful analysis of the data and trends. Fourth, the delays and inconsistencies greatly diminish the ability of MFNP to provide sufficient oversight and control over the nature of the expenditures. Because of these inadequacies, the MOFNP has found it difficult to provide an accurate, complete and transparent account of its financial position to parliament and other stakeholder, including the general public and donors.

While recognizing that computerization is not a panacea, an IFMIS will serve as useful and efficient tool for sound financial management. In particular, the system can help improve reliability and timeliness of financial data, strengthen financial controls, ensure better availability of comprehensive financial information, and ensure enhanced transparency and accountability of the Executive to the public. However, it should be emphasized that IFMIS is just a tool, and not a substitute for implementing the basic measures proposed in the preceding section to improve budget accounting and financial reporting. Indeed, IFMIS should be pursued as complementary to, and in parallel with, these basic measures.

There is wide recognition by the government and the donor community on the need for replacing the current manual accounting procedures and outdated technology at MFNP—which make it extremely difficult to obtain reliable and timely financial information and do not provide adequate safeguards for budgetary control—by a computerized information system. The challenge has been trying to design a system that can meet international accounting standards, while at the same time being implementable in a medium term horizon. The key issues and challenges in IFMIS development in Zambia are provided in the annex to this chapter.

Actions Taken to Date

Several efforts have been made by donors to assist MFNP in planning for a new IFMIS, although the primary assistance over the long term is expected to be through the Bank's PSCAP. During 2001, a Bank consultant helped the government with an assessment of the needs and potential options for a new system, including a rough timeline and potential costs for each. During that year, the EU also funded a consultant from KPMG to work with MFNP for several months to assess the needs for an IFMIS and to develop options to consider. This report, entitled "Project Management for the Integrated Financial Management Information Systems" was finalized in September 2001. It included recommendations on the functionality of an IFMIS, review of the Tanzanian experience, and roadmaps for three possible options of IFMIS. The consultant suggested that total cost of implementing IFMIS would range between US$8.3 and US$20.8 million depending on which option was adopted. The implementation period for each ranged from about six months to two and a half years.

An IMF mission in early 2001 also provided recommendations on managing the IFMIS implementation process and on the core functionality of the IFMIS. Their June 2001 report affirmed the MFNP's structure of a Steering Committee, a Technical Committee (or working group), and a Project Manager. The report recognized the need that MFNP would have for external consulting advice, but stressed the importance of in-house resources being fully involved in the project design, planning implementation of hardware and software, and other areas. Perhaps even more importantly the report outlined helpful guidance on the scope and core functionality of the IFMIS. Several highlights of the report recommendations have also been supported by others:

- The reference to an "integrated" financial management information system (IFMIS) may be misleading by implying that all functions must be captured by a single system. In fact, "some of the specialized information systems currently in place may still be required after the implementation of the IFMIS." These specialized systems could then become part of IFMIS through the use of "integrating" software.
- Even if all data is not captured within IFMIS, one nevertheless must anticipate the various interdependencies to ensure appropriate interfaces.
- A modular approach is best for the development and implementation of different components, with an initial focus on core functions.
- Core functions would include budget recording, commitments and funds control, payment process, accounting for disbursements and receipts, maintenance of the general ledger (GL), and generation of fiscal reports.
- The system would keep track of financial transactions at various stages.

In 2001, the MFNP established two critical working groups to shepherd development of the IFMIS. The first was a high level Steering Committee consisting of very senior officers to make policy decisions relative to IFMIS when necessary. The committee has included representatives of the Accountant General's Office, the Controller of Internal Audit, the Budget Office, the Data Processing Unit, Investment and Debt Management, Economic and Technical Cooperation, Central Statistics, ZRA, BoZ, the Auditor-General's Office, and a selection of ministry representatives (especially from the largest such as Education, Health, Works and Supply, and Agriculture). It has been chaired by the Secretary to the Treasury to ensure that speedy progress is made in specifying the requirements of the system.

The second important group was the Project Team or Technical Committee, whose full-time responsibility is to work with IFMIS consultants and to develop detailed specifications for the new system, among other tasks. Unfortunately, significant delays were experienced before the project team was appointed and before funding was found for them to begin work full-time. Ultimately, the team should be composed of representatives from each of the major functional areas—information technology, debt, budget, audit, accounting, and training—along with a Project Manager. The Project Team will take any policy decisions that need to be made to the Steering Committee for resolution.

Through PSCAP, the Bank had facilitated a study tour to Dar-es-Salem to examine first-hand the Tanzanian experience with IFMIS.[49] Although it is not clear how applicable the Tanzanian approach will be for Zambia, it provided an important reference point in terms of functionality, cost, and timeframes for the team to factor in. During 2002, the three-person Project Team and a short-term consultant made progress on several fronts. Four pilot ministries and a province were selected, and stakeholder workshops planned.[50] The Project Team also worked on the detailed system requirements in anticipation of the

49. The composition of the Project Team or Technical Committee has changed over time, so that those visiting Tanzania are not necessarily the same as those now working full-time.

50. As of October 2002, the five pilot sites were expected to be the Ministries of Finance, Education, Works and Supply, Health, and Northern Province.

arrival of long-term consultants. Enhancements have been made to the existing FMS, with the improved version rolled out in June 2002. This was expected to provide more timely information, enable the reconciliation of expenditures against the budget, and establish a commitment/arrears database. Plans were also developed for in-service training needs and research was conducted on the future telecommunications infrastructure.

Future Action Plan

Important modules that should comprise the IFMIS include:

- The Core Accounting Module (which would include linkages to the Activity Based Budgeting Module currently under development).
- A Cash Management Module (including a Statement of Cash Flows) to address the problems in budget execution that are caused by the cash budget and ad hoc cash management decisions.
- A Procurement Module to establish control over commitments. In the meantime, the manual procedures developed using the services of a Commitment Control Office and the revised FMS for on-line commitment control will have to suffice.
- A Human Resource Management Module is being developed separately under the DFID-funded Payroll Management and Establishment Control (PMEC) project to keep track of all employees, their grade and pay rate, and other pertinent personnel information. The system should ideally permit preparation of payroll with appropriate deductions, as well as linkage to the General Ledger accounting system.

The current plan is for the Government to pilot IFMIS by mid-2004. However, the Bank recognizes that full implementation of IFMIS is a medium- to long-term goal in Zambia. In its assistance to MFNP, the Bank has emphasized that whatever option is proposed to donors to be funded, needs to be manageable under the limited absorptive capacity of the Zambian public sector. Moreover, the modules and functionality, while designed to meet international accounting standards for whole-of-government reporting in the long term, also need to be able to produce more limited but tangible results in the short term. One such tangible measure may be for MFNP to be able to provide comprehensive, accurate, and timely reporting on expenditures and commitments for some subset of the overall budget (e.g., a few large ministries for spending in Lusaka province only). As MFNP begins to build a series of smaller successes with IFMIS, more and more functionality can be added, and one can expect greater donor support.

The Government has agreed that the best approach going forward is to adopt a turnkey system and to draw heavily upon the procurement experience of other countries in the region such as Uganda. In the short term, key actions related to IFMIS would include:

(a) Pre-qualify potential bidders
(b) Issue bidding documents
(c) Select and procure the software and hardware
(d) Continue stakeholder awareness workshops.
(e) Plan for in-house training needs for users and programmers.
(f) Pilot the IFMIS in selected ministries and provinces.

Related Issues for Success of IFMIS

Successful implementation of IFMIS demands some parallel reforms in public management over the medium term:

- Human resource management and compensation are inadequate currently to recruit and retain more highly trained staff in financial management or in information technology. If base salaries cannot be improved for the whole of civil service, some other creative strategy may be required to assure that MFNP and other line ministries obtain the skills that they need to perform these key support functions. (See the chapter on human resources in this report for further discussion of this point.)
- The legal and regulatory framework may also need changes in order to be consistent with new and more modern accounting procedures. IFMIS procedures must be designed to comply with existing regulations, or those regulations need to be updated. All parties also agree that it is inefficient and wasteful to automate outdated procedures that were designed around a primarily manual system. Yet, changes to the regulatory framework need to be managed well in order to prevent it from unnecessarily delaying IFMIS's development.
- Government-wide IT policy development and support has been generally nonexistent. IFMIS's development will introduce a new, larger infrastructure upon the government to maintain. And like more physical infrastructure, lack of investment will result in rapid deterioration in usability. Consequently, the government may need to assign special responsibilities to assure that public sector IT policies are dealt with strategically and that funds are preserved for maintenance and upgrading. The fact that the IFMIS project team is already initiating a review and upgrading of existing systems as a stop-gap strategy is a step in the right direction.

Sanctions must be enforced even as the new system introduces more discipline and transparency in public spending decisions. If audit findings or violations of policy are ignored, the gains from the new system will be lost.

Internal Audit

The internal audit function is critical for helping to ensure compliance with sound financial management. In Zambia, the role of the Internal Audit Department is set out in the Financial Regulations. The main internal audit functions are maintaining the pre-audit controls on expenditure, as well as assessing the overall adequacy of the financial management systems and procedures in place. In practice, various factors impact the effectiveness of internal audit, including the level of independence, the scope and content of its work plans, the level of resources available to it, and the degree of follow-up on its findings. In Zambia, the Internal Auditors have been effective in diagnosing problems in the financial management procedures, but their potential impact is still severely limited by the lack of adequate resources to carry out their work and insufficient incentive for Controlling Officers to implement on their recommendations.

Analysis of the Problem

The institutional relationships and structure of Internal Audit appear to give it ample independence from the line ministries and other entities. However, there may be some vulnerabilities that stem from the funding mechanism for its work. The Internal Audit Department is anchored within MFNP, and headed by the Controller of Internal Audits who in turn reports to the Secretary to the Treasury. Internal auditors are assigned to each of the line ministries, but their reporting lines are still to the central ministry. Promotions, transfers, and personnel matters are addressed through the central ministry. Although Internal Audit has a corresponding budget line within the line ministry budget, the actual release mechanism for the funds is under the authority of the Controlling Officer of the line ministry. Therefore, the independence of the internal auditors is not necessarily safeguarded by the current budgetary release practices. In practice, it has been reported that Internal Auditors have had full support from Controlling Officers, but there remains a risk that they could be penalized through the funding mechanism as a result of their findings.

Annual audit work plans could be improved by developing cost estimates and resource allocations across specific activities. Currently, the annual Internal Audit Work Plan is prepared by the Internal Audit Department within the line ministries in consultation with the Controlling Officer. These work plans are then reviewed and consolidated into an Internal Audit Work Plan prepared by the Internal Audit Department of the MFNP in December prior to the start of the Budget Year in January. Generally, activities fall in two categories: (i) Ongoing routine pre- and post-audit activities of expenditures files, procurement procedures, accounting ledgers, etc., and (ii) Specific audits of targeted projects or functions. The work plan identifies the targeted areas of activities, and develops cost estimates. However, only a portion of the work plan can actually be implemented effectively during the year.

Financial resources and staffing constraints are important barriers to Internal Audit's effectiveness. Even ongoing routine audit activities suffer from the shortage in personnel. For example, the Internal Audit Department assigns three auditors to each of the nine provinces to perform internal audit for the line ministries. However due to work overload, these auditors are restricted to providing services to those departments that fall under the Office of the President. The line ministries are responsible for providing the staff for their own internal audit requirements at the provincial and district level. This may be easier in theory than in practice. For example, at the Ministry of Agriculture an internal auditor had been assigned for only one out of nine provinces. At the time of this assessment, four more had been hired for assignment to four more provinces but were still located at the headquarters. Staffing constraints also mean that payroll audits are performed only on an ad hoc basis. (See Chapter 7 on the broader difficulties in recruitment and retention of qualified staff within the civil service.) Even with staff, there is a need for computers and logistical support for them to be efficient in carrying out their duties, especially in the districts. Although some institutional strengthening of MFNP has occurred already through PSCAP, it was not clear that the Internal Audit Department had as yet benefited significantly from this.

Finally, one of the most important factors in the effectiveness of Internal Audit (IA) is the magnitude of follow-up to its findings. When IA uncovers problems and recommends actions to be taken, it is critical that there be follow-through. Without the legitimate threat of sanctions, audits may be counter-productive by emboldening the behavior of wrongdoers. The responsibility to take corrective action lies with the Controlling Officer, who in turn should be held accountable by the Secretary to the Treasury. Unfortunately, effective follow-up often fails to occur. And though the Auditor General has authority to carry out audits to verify compliance with IA recommendations, severe budget constraints on the AG may prevent them from doing so.

Future Action Plan

- Establish a mechanism to protect funding for Internal Audit activities within line ministries.
- Increase staffing levels and RDC funding of Internal Audit
- Monitor and report on whether recommended sanctions are pursued in cases of misappropriation or fraud.
- Prepare a quarterly report that tracks implementation of the work plan.
- Improve annual work plans by incorporating the following:
  - Clear segregation of routine on-going activities from one-off ex-post audits.
  - Continue to identify the specific staffing and physical resource allocations necessary to carry out the activity, especially for those in districts, to ensure that all activities can be completed.
  - Combine cost estimates with prioritization of activities so that if budget resources are cut back, the work plan may be adjusted easily.
  - Increase coordination with the Office of the Auditor General in development of the work plan.

Effectiveness of External Audit

Article 121 of the Constitution provides for the appointment of an Auditor General (AG) by the President, subject to ratification by Parliament, and declares it a public office. It assigns to the office holder the responsibility of: (i) ensuring that the provisions of the constitution on public finance (i.e., Part X) are complied with, and (ii) auditing accounts relating to public revenues and expenditures. The Constitution grants the AG unimpeded access to all relevant public books, records, reports and documents. The AG is required under the Constitution to submit her/his audit report to the President within 12 months of the end of the financial year—the President has the responsibility for laying the report before Parliament within seven days of receiving it. The Constitution stipulates that the AG shall not be subject to the direction or control of any other person or authority in performing their functions. It provides for the AG to hold office until the age of 60 but s/he may resign before attaining that age. The AG can be removed from office for the following reasons: (a) inability to perform his functions due to infirmity of body or mind; (b) incompetence; or (c) misbehavior. The Constitution requires Parliament to set up a Tribunal to look into the matter constituting a ground for removal, and to consider the report of the Tribunal before removing the AG.

Similar provisions were made in the Finance (Control and Management) Act of 1969 and the Public Audit Act of 1980. The 1969 Act, amongst other things, empowered the AG to audit the accounts and reports of statutory corporations for which the law has not provided for the appointment of an auditor. It is noteworthy that the 1980 Act essentially gives the AG the authority to follow public money to anywhere it may go. It widens the power of the AG beyond the audit of books, records, and reports of government departments and the statutory corporations described in the 1969 Act to include the audit, as she/he deems fit, of every statutory corporation, and every private institution that receives Government grant, subsidy, or subvention in any financial year. The AG is empowered to request from independent auditors of state-owned enterprises (SOEs) any document, reports, or information relating to the accounts of SOEs. Also, every contract involving the Government or its agencies and enterprises was to include a clause allowing the AG to have access and examine all books relating to the contract. It also provides for the hiring of agents or specialist consultants by the Minister of Finance, at the request of the AG, to assist the AG in the performance of her/his duties.

Analysis of the Problem

There are adequate statutory provisions concerning the appointment, tenure, and auditees of the AG. Given the democratic setting, the functioning of the OAG can be significantly enhanced if the identified weaknesses are addressed.

While the AG, as a public official, enjoys adequate independence based on statutory provisions, in practice the OAG's independence is hampered by availability of adequate human and financial resources to discharge the AG's statutory responsibilities. Financial resources available to the OAG are subject to restrictions imposed by MFNP while staffing is subject to civil service regulations.

While the OAG has strived to adopt audit methodology recommended by the International Organization of Supreme Audit Institutions (INTOSAI) in practice, due to limitations in capacity the degree of compliance is low.

Although the AG's remuneration is a standing charge on the Government revenues as the remunerations of judges, the remuneration is inadequate, as it has not been reviewed for a long time. Inadequate compensation, especially when it involves lower pay compared to similar constitutional office holders can be demoralizing.

The AG does not have absolute control over staffing. OAG staff are recruited by the Public Service Commission (PSC). The service conditions of OAG staff are determined by the PSC in a manner similar to other public servants. Consequently, the AG is unable to retain qualified staff due to unfavorable conditions of service (Table 13).

Only one of the staff is a professionally qualified accountant, but there are several staff (about 15) with a first degree or above in finance and other disciplines. Because of the difficulty in retaining qualified staff, he has not been able to use effectively the few training opportunities that become available.

The AG does not report directly to Parliament. The AG submits her/his report to President who then lays the report before Parliament. That the AG does not have reports through the overall head of government departments that s/he audits, diminishes her/his independence. More often than not, serious actions are not taken on the audit findings. Not only does this lower the morale of OAG staff (and thus the quality of audit), but more importantly, it provides an incentive for further violations of the financial regulations. The primary responsibility for follow-up on the AG's report rests with the Minister of Finance, which in turn should be held to account by Parliament.

Table 13. Staffing of the OAG

	Staffing level	
Position	**Authorized**	**Actual**
Auditor General	1	1
State Audit Secretary	1	1
Director of Audits	5	4
Assistant Director	9	9
Principal Auditor	18	16
Senior Auditor	26	21
Auditor	30	27
Assistant Auditor	30	18
Audit Examiner	35	8
Assistant Audit Examiner	40	2

Source: Office of the Auditor General.

The OAG is not adequately funded to enable it carry out properly all the AG's statutory functions. MFNP determines the final budget estimate for the OAG that is incorporated in the Government budget and presented to Parliament for approval. Moreover, the cash releases, which are controlled by MFNP, are generally lower than the approved budget (see Table 14). The result is that the OAG is under-funded and has not been able to carry out all its planned activities.

The AG currently performs regularly financial compliance audits. This is in line with existing statutory provisions, which requires the AG to audit all the accounts charged to the general revenues, and to satisfy her/himself that expenditures are in line with Parliament authorization.

Table 14. Funding of the OAG for the Period 1998–2001

	1998	1999	2000	2001	2002
	In million Kwachas				
Amounts Proposed	6307	6100			
Amounts Appropriated	2468	2123	3573	3954	4944
Amounts Released	1868	1183		3798	3441
	In Percentages (%)				
Amounts Released as a % of Amounts Appropriated	76	56		96	70
Amounts Released as a % of Amounts Proposed	30	19			

Source: Office of the Auditor General; MFNP, Budget Office.

Recent Actions

In response to calls to strengthen the Office of the AG (OAG), the AG contracted three consultancies between 1996 and 2001. In 1996, a former AG of Canada was hired from Cowater Accountability Group, Canada to conduct a study to redefine the legislative mandate and strengthen the OAG. In 2000, a former Assistant AG of Canada was contracted to formulate proposals for the strengthening of the function of the AG and to enhance the effectiveness of the Public Accounts Committee. The World Bank funded both studies. In 2001, the AG contracted the services of Deloitte and Touche to assist in developing the necessary management and financial systems and procedures that would enable the AG to operate as an autonomous, transparent, efficient, and effective Supreme Audit Institution.

There have also been other attempts to strengthen the OAG. As part of the first of the Public Service Reform Program, the Management Development Division of Cabinet Office performed a management assessment of the OAG in 1996. Subsequently, the OAG held a Strategic Planning Workshop in May 1996 where its Mission Statement, Goal Statement, and Objectives were developed. The following year, Cabinet Office senior officials, some Parliament members and the OAG met to consider the recommendations contained in the 1996 consultant and management audit reports. On the basis of the recommendations, a Cabinet Memorandum was prepared and presented to Cabinet. Although a similar Memorandum was again presented to Cabinet in 2000, no action has been taken on the implementation of the recommendations.

Future Action Plan

To enhance independence, effectiveness and efficiency of the AG and his office, recommendations of the previous studies should be implemented and in particular:

- The OAG should be governed by an Audit Board (an oversight body).
- OAG's budget should be submitted directly to the parliament (after approval by the Audit Board).
- Staff should not be part of the civil service and its hiring and condition of service should follow different rules.
- The AG's report should be presented to Parliament as provided for in the Constitution.
- In order to allow her/him to adequately audit the republic's finances, the AG should also carryout performance audits and should audit the Central Bank as well.
- Finally, no one should escape controls and scrutiny; the OAG should be subjected to an external audit

PART III

Complementary Policy Measures and Issues

CHAPTER 7

The Human Resource Challenges for Effective Budget Management[51]

It is impossible to discuss the challenges to sound financial management in Zambia without understanding the human resource context in which it takes place. Even with the best information systems and regulations, sound financial management would be difficult to achieve without properly motivated and skilled staff. Problems in institutional capacity, however, are not limited to the functions of financial management and information technology management; rather they cut across the whole of the public administration. Many factors contribute to this including the low and declining real pay of civil servants, the lack of training and equipment, and the absence of an effective incentive system. During the 1990s Bank-sponsored projects such as the Public Service Reform Program (PSRP) attempted to address some of the problems that existed, but major tasks remain unfulfilled. Furthermore, there has been a concern that unless these issues were intensively addressed over the short to medium term, they could jeopardize successful implementation of other reforms such as the IFMIS. It is in this light that the Bank-supported Public Sector Capacity Building project (PSCAP) began targeting the government's training needs and remuneration policies as key components of its overall public sector reform agenda. Within the framework of PSCAP, the Government has set out to end the ad hoc system of pay increases and over-reliance upon allowances by implementing a Medium Term Pay Reform Strategy (MTPRS). The new system would aim to decompress and simplify the salary structure so that it is easier to retain and motivate professional and technical staff that will play key roles in driving reform efforts.

51. This chapter is based on the report "A Medium-Term Strategy for Enhancing Pay and Conditions of Service in the Zambian Civil Service," prepared by Ted Valentine working with a GRZ Technical Committee, which included representation from the Cabinet Office and the Ministry of Finance and National Planning, with funding from PSCAP on behalf of the Public Sector Capacity Building Projects (PSCAP) and the Zambian Management Development Division (MDD) of Cabinet Office.

Low remuneration and poor conditions of service are major factors contributing to the problem of poor productivity, motivation, recruitment, and retention of employees in the public service. At a time when Government is seeking efficiency improvements, in part by reducing the size of the civil service, there exist significant staff shortages in a wide range of professional and technical jobs owing to poor pay compared to that available in the private sector and within regional labor markets. While the major concern has been with regard to low and declining real public service salaries, the pay and incentives problems in the Zambia public service go far beyond the issue of low pay. Low pay coupled with a poorly constructed internal grading structure and an increments system that is based on the length of service rather than performance, stifles initiative and motivation. A further problem arises from the discrepancies that have crept into wages and allowances paid for comparable jobs in the civil service and of other sectors in the public service. It has been hoped that by addressing these pay issues it would be possible to secure significant improvements in individual and collective performance and in the quality of service.

This chapter starts off by providing a contextual background to understand how and why the human resource capacity of the public sector has been declining. It then gives a description of the principles and intentions behind the MTPRS initially developed by Government. It concludes with a brief update on how pay reform has been implemented thus far, and some of the new challenges that have arisen. In particular, it highlights the concern that negotiations with public service unions and others may have led to an overshooting of the wage bill resource and envelope, and postponement of key policy measures.

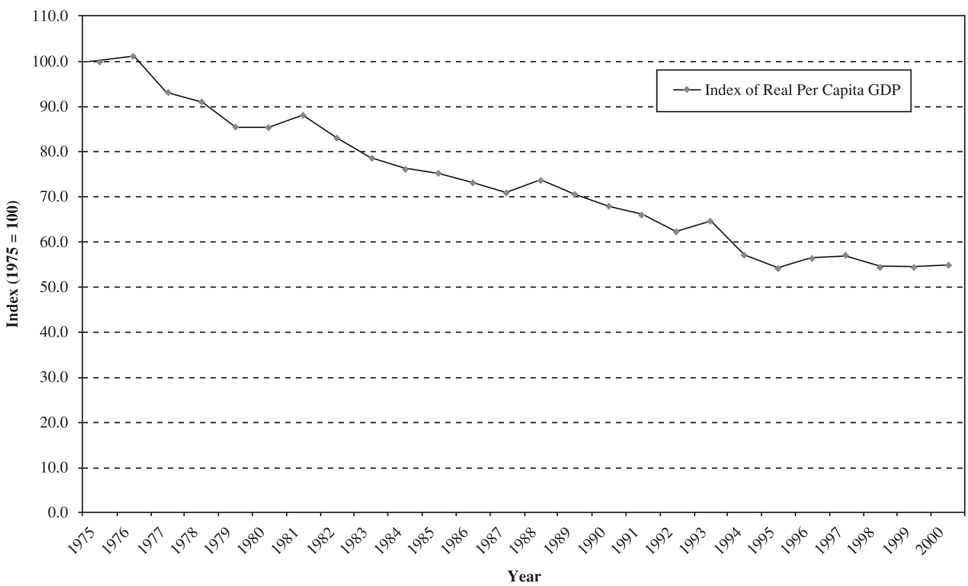
The Problem of Low Overall Pay

The decline in real wages for civil servants in Zambia generally mirrors the overall macroeconomic decline of the country since the mid-1970s. For much of the past 27 years the Zambian economy has suffered through economic crisis, volatility and decline. The downward trend in the economy was precipitated initially by the fall in the price and output of copper. However, as noted in Chapter 2, the problems in the economy went far beyond the decline in the mineral sector. Figure 2 presents an index of real GDP per capita for the period 1975–2000. Here the declining tendency in the economy is apparent. By 1983, real GDP per capita had declined to only about 79 percent of its 1975 level. By 1990, it had declined to 68 percent of its 1975 level. Between 1991 and 1995, as a result of severe drought and continued decline in copper production, real GDP per capita declined by more than 20 percent. By 2000, real GDP per capita had declined to only about 55 percent of its 1975 level.

As in other countries in sub-Saharan Africa, the declining real public service pay trends were the result of several factors. First, real wage repression was attributable to a worsening public sector financial crises (i.e., a central government's budgetary deficit crisis and a parastatal financial crisis) which reduced the government's capacity to cover aspects of recurrent and public investment expenditures.[52] Second, was the "wage equalization policies" pursued by many countries, including Zambia, which were driven by various governments' desire

52. Under the circumstances facing many SSA countries, attempting to address fiscal crises by cutting government wages (and the wage bill) could lead and have actually led to an increase in the budget deficit. See for discussion van Rijckeghem and Weder (1997) and Haque and Sahay (1996).

Figure 2. Index of Zambia's Real Per Capita GDP, 1975–2000



Sources: Rakner, et al., 1999, Tables 4 and 5; *Standard Bank,* 2002; and Republic of Zambia, 2001.

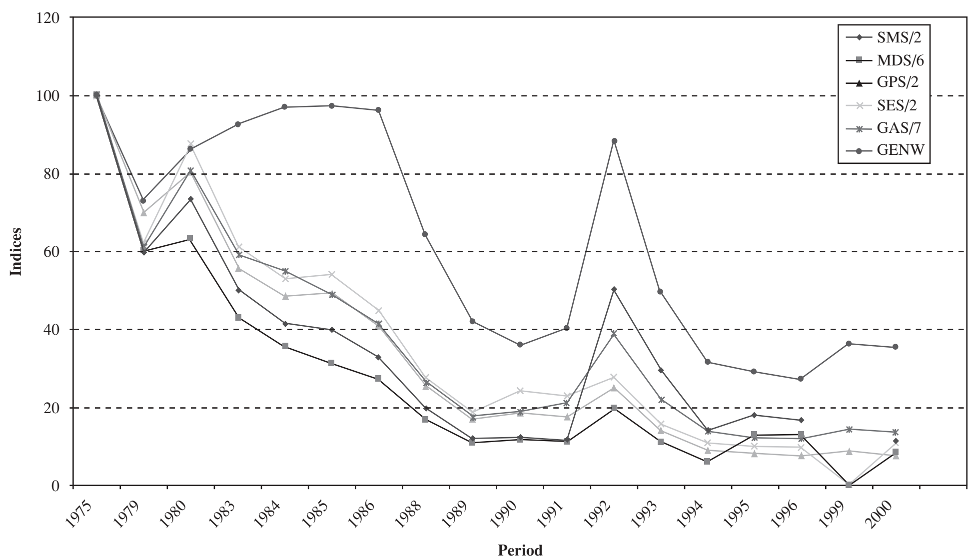
for general pay restraint to narrow the urban-rural income gap, and which targeted pay restraint to reduce pay differentials between high-salary and low-wage employees.[53] Third, many governments showed willingness to trade off real wage levels against higher levels of public service employment. Fourth, central government wage bills became overcommitted as the governments became over-extended. The central government wage bill had to cover not only central government administration, but all of provincial and local administration personnel, as well as cover the shortfalls in the capacity of state industries to meet the labor cost of their personnel. Fifth, and finally, was weak public-expenditure management, which was partly related to the problems of wage-bill planning and controls. These factors gave rise to a paradox where the civil servants were underpaid, but the wage bill became an increasing burden on the general citizenry.

Figure 3 presents indices of real pay trends in the Zambia public service for various salary groups for the period 1975 through 2000. Three significant patterns emerge in public service real pay trends in Zambia. The first period is 1975–1983, the second is 1983–1991, and the third is 1991–2000.

During the first period, real public service salaries declined sharply (by about 30–40 percent for most salary groups between 1975 and 1979), before recovering much of their value in 1980 (returning to 70–85 percent of their 1975 value). Overall, the decline in real salaries was not nearly of the magnitude of the reductions in real GDP. Between 1982/3

53. Some sub-Saharan countries, including Ethiopia, Mozambique, and Tanzania, have followed socialistic wage equalization policies.

Figure 3. Indices of Real Minimum Salaries for Various Civil Services Salary Grades, 1975–2000



and 1991, all salary groups experienced substantial and uninterrupted decline in their real public service pay. By 1991, the real public service pay for most salary groups had declined to only 11–22 percent of their 1975 value.

The third period covers the years from 1991–2000. This period was marked by a change in government, the introduction of a number of economic reform initiatives and a comprehensive public sector reform program. Still between 1991 and 1995, the country experienced negative economic growth. Between 1995 and 2000, economic growth was low and volatile, averaging 1.9 percent per annum, while fluctuating drastically from year to year. Given the economic growth situation, there was little scope for sustained improvement of real salaries in the public service. Real public service salaries fluctuated significantly, but for the most part moved in a downward direction for most salary groups. By 2000, most salary groups had experienced real public service salary declined of the magnitude of 85–90 percent in comparison to their 1975 value.

Overall during 1975–2000, real public service pay declined much faster than did real GDP per capita. Still the wage bill remained large relative to other government non-debt service recurrent expenditures and was perceived to have crowded out expenditures on public goods and services.

The Fragmented Salary Structure and Overuse of Allowance

The Zambian job grade structure is quite fragmented, with a large number of different occupation-based job scales in use for different staff categories. There are broad 26 job-grade scales in the current job-grade structure. This excludes grades associated with the

Anti-Corruption Commission, the UTH Health Board, and Medical Health Boards, whose personnel are paid through the central government payroll, though they are semi-autonomous agencies. When the segmentation of these occupational groups into "management," "unionized professional and technical," and "unionized classified personnel" are taken into consideration, the number of job-grade scales increases to about 40.

The job structure is populated with 185 job grades—far in excess of what is considered manageable and desirable for the standpoint of the capacity to access and maintain horizontal and vertical equity.[54] Yet many job scales contain few grades (as few as one) and few personnel within them. In addition to the above scenario, a KPMG study revealed that career progression opportunities in the Zambian Public Service are very minimal.

The public service job-grade and corresponding salary-grade structures have not always been so fragmented. Before the problems in the economy, the structure was fairly unified. But in the absence of a coherent pay policy, over time, various unions have successfully negotiated for changes in salary, as well as terms and conditions of service, in a hope to increase their nominal, if not real, monetary compensation levels.

The proliferation of salary scales and salary grades has made it very difficult to achieve and maintain horizontal and vertical equity in the salary structure. Salary differentials, both grade and increment/step differentials, are far too small to motivate staff to improve performance and to move up the job ladder. In many cases salary increments are in the range of 0.45–0.70 percent. Small salary differentials throughout the salary structure have led to a fairly compressed salary structure across all salary scales. This has reduced the value that the public service places on educational qualifications, skills, and experience. The result has been a reduction the competitiveness of the service to attract and retain suitably qualified manpower.

The problems with public service compensation in Zambia go far beyond salary differentials and the salary structure. There are problems with the broader compensation structure itself. For some salary groups, the other forms of compensation payment are far in excess of the salary and wages. Compensation in the Zambia public service is very fragmented. Personnel on the December 2001 payroll could receive payments from as many as 139 possible sources of compensation. These include:

- 16 salary and wages payment categories,
- 6 flexible allowances,
- 47 fixed allowances,
- 14 other emoluments payment categories, and
- 56 arrears payment categories.

Among other things, the dependence on so many allowances to enhance compensation weakens horizontal and vertical equity. They also diminish the relationship between pay, performance, and responsibility, as in many instances lower-paid subordinates may receive higher total compensation than their superiors. At 10 percent of total monetary compen-

54. Horizontal equity refers to the comparability in pay for positions of similar weight or responsibility across government. Vertical equity refers to the appropriateness of pay from one grade to the next higher grade. In other words, positions with clearly different requirements and responsibilities should be compensated differently.

sation, total monetary allowances as a proportion of monetary compensation is not very large in comparison to the compensation mix currently experienced by the Kenya public service or that of Tanzania before implementing pay reform. Yet the proliferation of allowances is quite problematic for salary administration. It contributes to fluctuations in the monthly wage bill and is difficult to plan for. This is one explanation for the large number of categories of arrears and the amount of arrears in the wage bill.

The Impact on Quality of Services

As indicated above, the prolonged effects of declining real pay and general conditions of service in the public service negatively impacted work motivation, performance, capacity building and commitment to public service. Increasingly, with erosion of real pay came the depletion of scarce human and motivational capital in the public service, giving rise to:

(a) demoralization and demotivation of subordinate employees and their supervisors/senior civil servants;
(b) reduced work effort, declining levels and expectations in performance;
(c) reduced incentives for improving work performance and willingness to accept greater responsibility;
(d) the weakening of accountability and control procedures/mechanisms;
(e) diminished ability to recruit and retain qualified managerial, professional, and technical manpower; and
(f) reduced commitment to public service.

In addition to reduced work effort, low and declining real pay may lessen goodwill, increase ill-will and motivation to engage in counterproductive behavior antithetical to increased production, service delivery, good fiscal management, and sound government resource allocation. These may give rise to both the incidence and tolerance for "deviant work behavior" in the public service. Here deviance is viewed within the context of:

- production deviance, which includes work slow downs, misuse of paid work time to engage in non-work activities, or "time theft"; and/or
- property deviance, which refers to the (mis)appropriation or misuse of public institutions' tangible and/or financial assets for personal gain.

By combining the resources that they control internal and external to their place of employment as best they can, adopting their income-maintenance strategies, public servants are perceived as responding pragmatically to the financial predicament in their attempts to maximize their incomes.

These income-maintenance strategies took on various forms. While some had no direct bearing on work performance and service delivery—though they might affect commitment to employment and work motivation—others did. Those strategies that had the greatest impact on service delivery fell into four categories:

(a) work sharing, where public service personnel agreed implicitly/informally between themselves to share work loads to allow workers to pursue other income maintenance activities during official work time, lowering actual work-time and generating personnel rotations at staffing levels far below those formally expected;

(b) bribery, where public servants solicited payments directly from customers/clients before providing (otherwise) free public services, and/or request payments in excess of the formal service fees or user charges set by public institutions;

(c) revenue sharing, where revenue from formal user charges were misappropriated or mismanaged for individual gain; and

(d) resource sharing, where public resources, supplies and equipment were misappropriated, pilfered, or mismanaged for individual gain.

Employing such income-maintenance strategies has had significant negative implications for service delivery quality and accessibility, as well as on the government's fiscal situation and on capacity building in the public service.

The Link to Corruption

The relationship between corruption and pay has invoked much debate in administrative and general civil service reform discussions. Not all behavior through which civil servants derive personal gain from the use of public resources need be lumped into the a single "corruption" basket. Nevertheless, the low-pay/petty-corruption relationship is fairly clear drawing from evidence of the efficiency-wage analyses of economics and the deviant work behavior analyses of organization behavior and human resource management literature. The pursuance of many income-maintenance strategies generally leads civil servants into what the organization behavior and human resource management literature commonly refers to as deviant work behavior. But unless actions are taken to punish corrupt behavior, pay increases alone will do little to change the cost/benefit calculation and corruption need not abate. Changes in compensation levels can be part of a package to reform civil servant behavior but other elements are essential to reduce corrupt practices.

A survey in Tanzania found that the payment of fair compensation in itself would not be enough to encourage increasing performance among some segments of the workforce. The survey raised two issues. First, the pay increase must meet the workers' minimum expectation of fair compensation before they are willing and able to commit fully to their work. Second, improved pay in itself is no guarantee that the workers' choice of a level of work effort will match that desired by the government (as an employer). Increased pay may be a necessary though not sufficient condition for increased commitment and performance. Mechanisms, therefore, must be developed to improve accountability, monitor performance, and institute rewards and penalties.

Salaries are not the only motivating factor for performance improvement. The lack of availability of complementary inputs, as well as institutional, environmental and managerial problems play major contributory factors in low service delivery and performance. These clearly need to be addressed. However, it is only when the pay and incentive problems are adequately addressed that we can realistically expect the process towards the evolvement of an effective, efficient and motivated public service to begin and capacity building efforts to become more effective.

Recommendations

Actions Taken to Date

The GRZ has not had an explicit public service pay policy. From independence until the early 1980s, the Zambia public service salaries and other terms and conditions of service have been reviewed after intervals averaging four years through external Salary Commissions appointed by the Government in an attempt to motivate civil servants for increased efficiency and productivity. Salaries were generally adjusted on the basis of government affordability, past inflation levels, prevailing economic conditions, and to maintain some degree of parity with public enterprises for similar jobs. As salary adjustments were made in four-year intervals, after a large adjustment in the initial year, public services had to forgo salary increases in intervening years. Unfortunately, these commissions, while reviewing public service remuneration and conditions of service generally, offered only piece-meal solutions to addressing the problems of the public service. This created further distortions across the various groups of personnel employed by the public service and within groups themselves.

As inflationary pressures persisted and budgetary constraints became more severe, periodic wage determination by ad hoc salary commission gave way to direct collective bargaining between government and respective unionized public servants. Over time, more and more personnel sought the protection of unions, as they felt that they could better influence the wage determination process for their occupational group if they took collective action. The notion of a public service salary structure and salary scales had given way to a collection of unionized salary scales, where the overall salary structure was nothing more than a collection of ad hoc derived salary scales.

As a result of implicit GRZ pay policy, fringe benefit and monetary allowances have progressively been used as a major vehicle for increasing compensation, particularly for upper-middle level and senior civil servants. The allowances have included: acting, special duty, hardship, responsibility, non-practicing, commuter/transport, risk, security, extraneous duty, field, overtime, honoraria, accommodation leave, transfer, entertainment, telephone, utility, mileage, subsistence, settlement, uniform among others. This has resulted in a situation where allowances and fringe benefits:

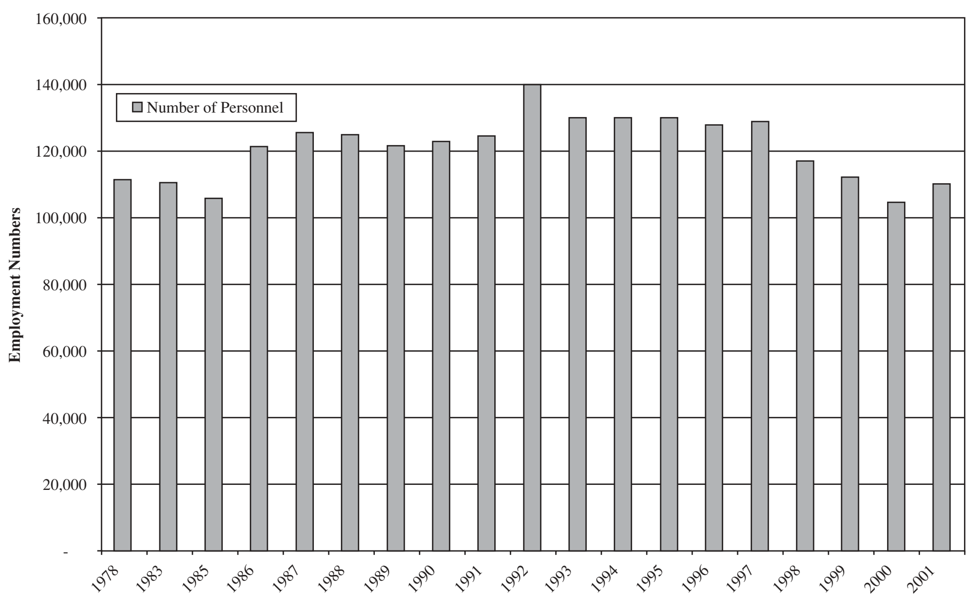
- have increased significantly in terms of their number and in value, both relative to salaries and in absolute terms;
- are enjoyed disproportionately by various cadres and grades of civil servants; and
- have in some instances replaced pay as the major component of the compensation package.

Although initially conceived in 1993, the Public Sector Reform Program (PSRP) was revised in 1997 and jumpstarted then after years of relative inactivity. The initial PSRP came on the heels of a long series of structural adjustment programs that failed to adequately address the government's budgetary situation or the problems in service delivery and access. The short-term objectives of the PSRP were to reduce government's budget deficit by cutting down its labour force, to rationalize government structures and functions, to strengthen capacity, and to improve operations and maintenance facilities. The long-term objective was to improve efficiency and productivity of the public service.

Given that the wage bill was and is large relative to government recurrent expenditures, to avoid further crowding-out of operational and maintenance (O&M) expenditures, salary enhancement within an affordable wage bill was seen to necessitate staff reductions. As public service employment had increased substantially between 1985 and 1991 (Figure 4) (which reflected the willingness of the Government to trade off increased real wages for higher levels of employment), reducing the size of the public service was perceived as a major priority of the PSRP. The objective of the Pay and Rightsizing component of the PSRP was to ensure that the remuneration package was sufficient to cover the basic needs of public servants and that provided sufficient compensation to attract and retain competent and efficient civil servants.

The PSRP pledged to reduce public employment by 25 percent within three years and to improve the conditions of service of personnel who remained in an attempt to improve the competitiveness of the public service to attract and retain personnel with the requisite skills and experience. However, no retrenchment took place within the proposed period. The main obstacles to the PSRP retrenchment exercise were two-fold. The first was related to the cost of the severance package. The second was the absence of an objective and systematic assessment of the employment requirements on a government ministry-by-ministry and department-by-department basis. Under the Employment Act the mandated retrenchment costs was the equivalent of about 12 years salary for each retrenchee. Given the political cost and economic cost associated with retrenchment, perhaps the government decided that it was easier to retain workers rather than to retrench them.

Figure 4. Public Service Employment Trends, 1978–2001



Sources: Colcough 1997, Table 4.3, p. 73; International Monetary Fund, Figure, Number of Public Servants, 1989–99, page 5; Data Centre, MFNP.

Beginning in 1997, greater effort was made to control employment levels. Yet, the initial reductions in employment numbers could be attributed almost exclusively to a reduction in the industrial class personnel, those with no permanent employment tenure in the public service. Employment levels were reduced through a retrenchment and voluntary early retirement scheme in 2000. Still employment has shown a rising tendency again. After averaging nearly 104,000 per month during the first nine months of 2000, personnel numbers rose steadily on a month-to-month basis from October 2000 to August 2001, from about 105,800 to about 113,260, before declining to an average of about 109,700 per month during the last three months of 2001.

Future Action Plan

The status of the Government's pay reform strategy should be described in two phases: (1) development of the overall strategy and principles, including tentative cost projections, and (2) updating and partial implementation of year 1 in 2003. Under PSCAP, GRZ commissioned a short-term consultant to conduct a study of pay and employment issues. The objective was to assist GRZ to develop a strategy for enhancing pay and conditions of service in the public sector that laid out broad policy options, established links to major parameters of the policy and identified the principles upon which the pay policy will be built. Development of the pay and conditions of service policy will take time and its introduction and translation into pay awards will also take a number of years. However, there has been a pressing need to introduce measures quickly to address critical pay-related constraints to improved service delivery within the context of a pay policy. In particular, immediate steps have been required to boost remuneration for managerial and qualified professional and senior technical personnel. The medium-term pay reform strategy (MTPRS) was a first step towards the formulation of a Government pay policy, which would address all aspects of work motivation and requirements for attracting and retaining personnel in the public service.

Salary enhancement is only prudent and sustainable when undertaken within the context of the likely resource envelope. Government recurrent expenditures must seek to strike an appropriate balance between the public service wage bill and expenditures on operation and maintenance. Regarding the size of the public service, the proposed reductions/right-sizing measures proposed in 2000 by KPMG aside, it is unclear whether there is scope for additional employment reduction. With the vast majority of public servants being employed in the priority areas (75 percent being engaged in education, health, and the protective services), there is little scope for financing pay reform from downsizing of the public service alone. Though, there is still need to rationalize public service employment and to shift away from a low skilled workforce to a more skilled, professional and experienced public service. A major constraint on salary enhancement in the Zambia public service is the slow rate of real growth, which restricts the resource envelope.

In the absence of any other statement of pay reform priorities, those presented in the revised PSRP document (Republic of Zambia, 1997) are still taken to be relevant to the current situation. The specific proposals on pay reform are:

(a) Control the size and growth of government employment;
(b) Rationalise and enhance public service pay by:

(i) eliminating the distortions and anomalies that have crept into the system;
(ii) providing equal pay for equal work; and
(iii) paying salaries commensurate with skills experience and responsibilities.

(c) Senior and middle ranking staff should have their pay progressively decompressed to the new target levels to increase their competitiveness with pay levels obtainable in the non-government sector in Zambia.

(d) At lower levels, pay increases would be only sufficient to offset inflation. Pay increases only for inflation (no increase in real pay levels) for all lower-ranking staff.

(e) All employees should have their pay consolidated to include all allowances. Allowances should be progressively absorbed into basic pay, with junior ranks receiving "pay protection" to ensure that they are never worse off.

With these goals in mind, the PSCAP consultant proposed four possible scenarios shown in Table 15. Of these, Scenario 4 was the preferred one by Government because it would do most to decompress the salary structure and make the civil service more competitive.

Table 15. Scenarios Assumptions Matrix

Contrast	Wage Bill/GDP Ratio	Employment Trends	Salary Structure
Scenario 1	The Wage Bill/GDP ratio declines by 0.5% of GDP from 2002 to 2003 and remains constant thereinafter.	Size of the public service remains constant at 2001 level.	New salary structure introduced. Salary differentials (increment and grade differentials) remain constraint through the period.
Scenario 2	Same as Scenario 1.	Size of the public service reduced in line with the KPMG report recommendations.	New salary structure introduced. Salary differentials (increment and grade differentials) remain constraint through the period.
Scenario 3	Same as Scenario 1.	Same as Scenario 2.	New salary structure introduced. Salary differentials (increment and grade differentials) rise through the period.
Scenario 4	Same as Scenario 1.	Same as Scenario 1.	New salary structure introduced. Salary differentials (increment and grade differentials) rise through the period. Allowances are eliminated for the compensation structure.

A key feature in Scenario 4 was the partial consolidation of allowances and a move towards a "clean" wage bill. It should also be noted that compensation could be enhanced even further with a reduction in the size of the public service. Yet, as noted indicated earlier, the scope for employment reductions in Zambia is likely to be much smaller than many analysts expect.

Inasmuch as donor-supported intervention complements the medium-term pay strategy it will facilitate improved performance and capacity building in the public service. Years of reliance on ad hoc local cost compensation (LCC) arrangements[55] have evolved into a situation where the Zambia public service has to compete with donors for scarce managerial and qualified professional and technical personnel. While a stated intention of donor salary top-up arrangements may be to increase the public services ability to attract and retain better-qualified professional and technical personnel, the ad hoc nature of this type of donor intervention has unintended (negative) consequences. It is not yet clear on how best to move away from this entrenched practice. However, as one option, the Government (through the PSCAP consultant) has proposed that donors pool a proportion of the resources that they would normally earmark for LCC and contribute to the establishment of a scheme that will better complement the medium-term pay reform strategy. By doing so, ad hoc LCC arrangements could be transformed into a systematic scheme where donors collectively support the government's efforts to improve its capabilities to attract, retain and adequately motivate its personnel and build the requisite human resource capacity to facilitate improved service delivery and strategic outputs. This scheme is referred to as the Selective Accelerated Salary Enhancement (SASE) scheme. It is proposed that through the SASE scheme donor-funds support an accelerated pace of salary enhancement for managerial, professional and technical personnel. As one option for addressing the urgent need to improve pay and incentives for key staff, the SASE scheme merits further review and consideration. Further explanation of the justification and broad modalities of SASE is found in the annex of this chapter.

Finally, it must be stressed that increased pay may be a necessary, though not sufficient, condition for increased commitment and performance. Mechanisms, therefore, must be developed to improve accountability, monitor performance, and institute reward and penalties. Consequently, a new performance management system and employment policy is also of critical importance. Specific proposals concerning the development of a performance appraisal system, along with complementary policies for performance-based pay rewards and job evaluation and re-grading are found in the report "A Medium-Term Strategy for Enhancing Pay and Conditions of Service in the Zambian Civil Service" prepared by Ted Valentine on behalf of PSCAP and the Management Development Division of Cabinet Office.

Initial Implementation of Pay Reform. In late 2002, it became evident to Government that the underlying assumptions on which the MTPRS was based were outdated and needed revision. In particular, the estimated wage bill had risen from 6.3 percent of GDP to over 8 percent. GRZ found that anticipated GDP growth in 2003 would enable it to offer approximately K 142 billion for salary increases in 2003 before hitting its IMF-agreed upon ceiling of 8 percent. This amount was recorded in the 2003 Yellow Book.

55. Given the pay and incentives problems confronting the public service, donors sometimes provide incentive payments and salary supplements to key public service posts where incumbents are engaged on donor-funded projects and programs. Such payments are referred to as local cost compensation (LCC). These payments are perceived to attract, retain and motivate personnel, as well as to ensure higher levels of performance and commitment from otherwise lowly paid and (potentially) demotivated public servants. LCC salary supplements are generally far higher than the basic salaries paid to personnel with comparable responsibilities, though these vary significantly from donor to donor, project to project, as well as within a project depending on the funding arrangement.

Unfortunately, pressure from unions and other groups within the public sector, led to GRZ agreeing to pay increases for 2003 that may cause the wage bill to exceed the 8 percent of GDP target. Finding off-setting savings will become a important priority for the remainder of the year. Finalizing the severance packages for those who have been identified for retrenchment will help;[56] while additional savings should be available from cleaning the payroll database.

With the 2003 pay increases, GRZ began the process of decompressing salaries and reducing the number of separate salary scales. Pay increases were especially weighted toward mid-level technical and professional positions, where retention and recruitment is especially difficult. Yet, negotiations with the civil service and teachers unions failed to achieve a consolidation of allowances into base salary, and this will need to be pursued again in 2004.

In summary, the main recommendations are that GRZ:

(a) Complete the payroll data cleaning exercise and retrenchment packages, and use the savings to off-set the cost of the 2003 salary increases.
(b) Over the short to medium-term, continue to target salary enhancement towards professional and technical personnel that the Government has most difficulty in attracting and retaining and who are most critical to efforts to raise public service efficiency and the quality of service delivery;
(c) Rationalize the pay structure by substantially reducing the proportion of salary paid as allowances in 2004;
(d) Conduct a special assessment of whether SASE or another program can be developed to target immediate pay awards to critical staff based on performance or special skill-related job characteristics.

56. About $10 million of the severance package is being funded through PSCAP.

CHAPTER 8

Service Delivery in Practice: Leakages and Equity in The Flow of Funding to Education in Zambia[57]

Study Methodology

This chapter summarizes the expenditure and service delivery survey (ESDS) for the basic education sector carried out as part of the PEMFAR in 2002. Basic education was selected for being a priority sector for poverty reduction and was deemed a good candidate to test the linkage between budget design and execution on the one hand and outcomes/results on the ground, on the other. The main ESDS finding is that allocating more central budgetary resources to the sector does not, by itself, guarantee better educational outcomes: budgetary resources (if released by the Ministry of Finance) may not reach the intended beneficiaries, and even if they do, these resources may not result in better educational outcomes.

While the Government of the Republic of Zambia (GRZ) has, from independence, recognized the importance of education and increased budgetary allocations to the sector, the sharp decline from the mid-seventies onwards in copper prices has led to a commensurate decline in Government revenue and per capita incomes (which declined from US$590 in 1975 to US$300 in 2000). Because of these declines, the education sector in Zambia faces several obstacles and, consequently, most education indicators have deteriorated over the last decade. To overcome some of these obstacles, the Government and the donor community have been working closely to improve both educational inputs and outcomes. In this regard, it is important to assess (i) the current record of the educational sector in delivering services to the intended recipients; and (b) whether some reforms/changes undertaken by the Ministry of Education have resulted into desired educational outcomes?

57. This Chapter is a summary based on Das et. al. (2002).

The ESDS sought to address these questions through a detailed evaluation and tracking of educational expenditures earmarked and assess the extent to which such resources actually reach schools and the poor in society (that is, whether such expenditure is progressive or pro-poor). The Zambia ESDS addressed four main issues:

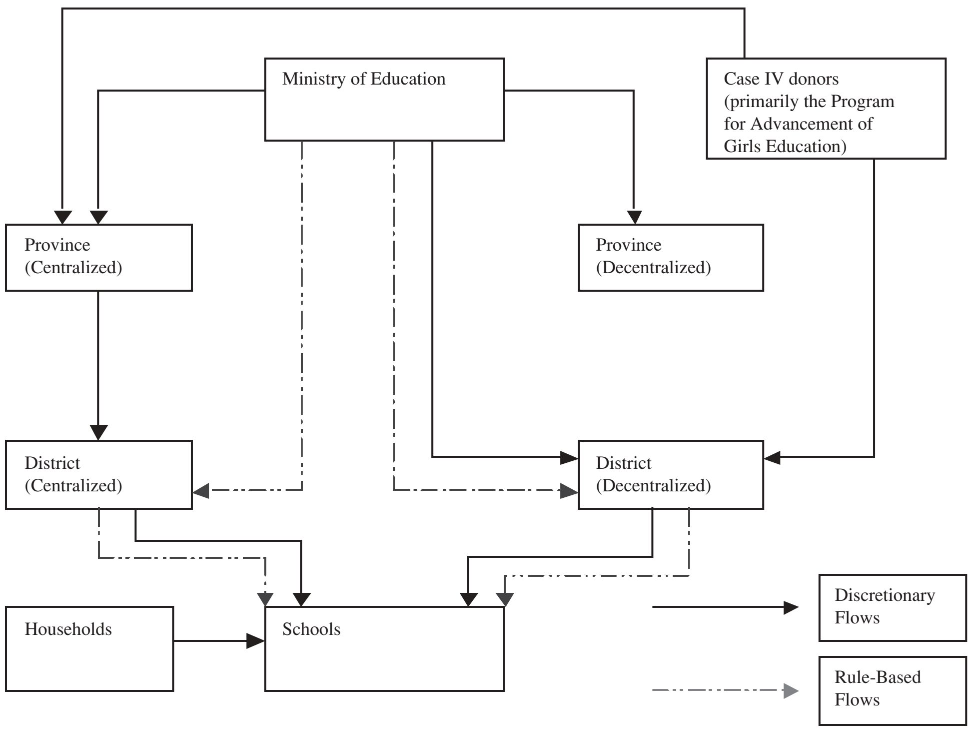
(a) What percentage of resources is spent at each level of the administrative hierarchy?
(b) To what extent is variation in funding across districts and schools explained by 'funding-formulas' that relate budgetary allocation to district/school characteristics such as enrollment or the number of schools?
(c) To the extent that there is variation in funding across districts and schools, what is the relationship between this variation and characteristics of districts and schools (for instance, is it the case that richer districts/schools systematically receive more funds)?
(d) How important is private funding in the provision of education and how does this component of funding relate to equity in the overall funding of education?

The flow of funds from the Ministry of Education Headquarters to schools in Zambia is organized through a three-tiered administrative hierarchy involving provincial offices, district offices and schools. The normal flow of funds is in a "top-down" manner—at each tier of the hierarchy, funds may be allocated directly either from the Ministry Headquarters or from international and local donors. The ESDS classified the allocations of funds into four different categories: rule-based allocations to schools, discretionary allocations funds to schools, rule-based allocations to teachers, and discretionary allocations to teachers. The characteristics of each of these four categories is described below:

(a) Rule-Based Allocations to Schools: This is a fixed-grant allocation to schools, that is either US$600 or US$650, depending on the type of school. It is important to note that this is not a per pupil allocation—the grant is independent of the enrolment and other characteristics of the schools.
(b) Discretionary Allocations to Schools: This is monies given to schools over and above the rule-based allocation. Such funds are allocated at the discretion of districts and provincial education officers.
(c) Rule-Based Allocations to Teachers: The payment of salaries and monthly allowances is administered through a centralized payroll in Zambia, whereby teachers directly receive their "deposit slips" without any money going through either provinces or districts. Such payment is regarded as being rules-based.
(d) Discretionary Allocations to Teachers: In addition to regular salaries and monthly allowances, teachers are also entitled to time/event benefits, such as leave and transfer/relocation (paid when a teacher switches schools) and funeral benefits. Because of persistent inadequate funding from the Ministry Headquarters, the payment of such benefits is left to the discretion of the province and district level administration despite the fact that the terms and conditions of service for teachers categorically specify that they are eligible to be paid such allowances. The observed frequent withdrawal of labor by the various teachers unions is, among other factors, as a direct result of this.

In order to improve education service delivery, the education sector is currently piloting decentralization through the creation of district education boards. The ESDS divided provinces into those with district education boards and those without. Such a distinction is necessary since in the former provinces very little money flows from the province to the district; districts receive money directly from the Ministry both for rule-based and discretionary allocations. In the latter case however, while districts continue to receive money directly for rule-based allocation, all money for discretionary allocations is first allocated to the concerned province and from there onwards to the district. For this reason, the Ministry terminology to refer to the former as decentralized provinces and the latter as centralized provinces was adopted by the ESDS. In the ESD sample there were two of each: Lusaka and Copperbelt province are decentralized while Northern and Eastern are centralized. Figure 6 diagram below shows how funds are allocated across these two types of provinces.

Figure 5. Funding Flows Diagram



Expenditure Tracking

The ESDS tracked all non-salary funding flows (recall that most payroll flows are allocated directly to teachers) through the administrative hierarchy and established the following characteristics:

(a) On average about K28,000 per pupil enters the educational system for the four provinces of the ESDS. However this average amount hides a significant degree of variation within these provinces with, for instance, Eastern Province (K44,300) receiving more than double the per pupil funding received by Copperbelt (K19,000).

(b) Of this amount, discretionary Funds at the level of the province and district account for 70 percent of all funding while rule-based funds account for the remaining 30 percent: Thus rule-based funds allocated through the fixed school grant of US$600 (US$650) account for less than one-third of all the funding received.

(c) Between one-sixth and one-third of total funding in the system eventually reaches schools: Of this total amount between 14 percent (Lusaka) and 34 percent (Copperbelt) eventually reaches the schools as a combination of rule-based and discretionary spending while the rest is spent at the provincial and district levels.

(d) Decentralization has shifted spending from the provincial to the district level, but has not resulted in greater disbursements to schools: There are important differences between centralized and decentralized provinces up to the level of the district: centralized provinces spend more at the provincial level compared to those that have been decentralized. Thus in Eastern (38 percent) and Northern (18 percent) provinces a higher percentage of funding is spent at the provincial level compared to Copperbelt (9 percent) and Lusaka (5 percent). However, the extra funding that reaches the districts in decentralized provinces just results in higher spending at the district level and is not associated with greater funding to schools in those districts.[58]

These findings are summarized in the funding disbursement graphs below (Figure 7) where we plot Kwacha per pupil (K) funding at each level of the administrative system. The amount that finally reaches the school is much less than the total amount available in the system and this decline is the sharpest in Eastern province (despite having the largest average allocation per pupil in the sample). In effect, the differences in funds available at the province level are due to the nature of the rule-based component of funding, whereby provinces with lower average enrollments receive greater per pupil funding than provinces with the same number of schools but higher average enrollments. Consequently, the low disbursement curves in the decentralized districts when compared to the centralized district are as a direct result of the rule-based component.

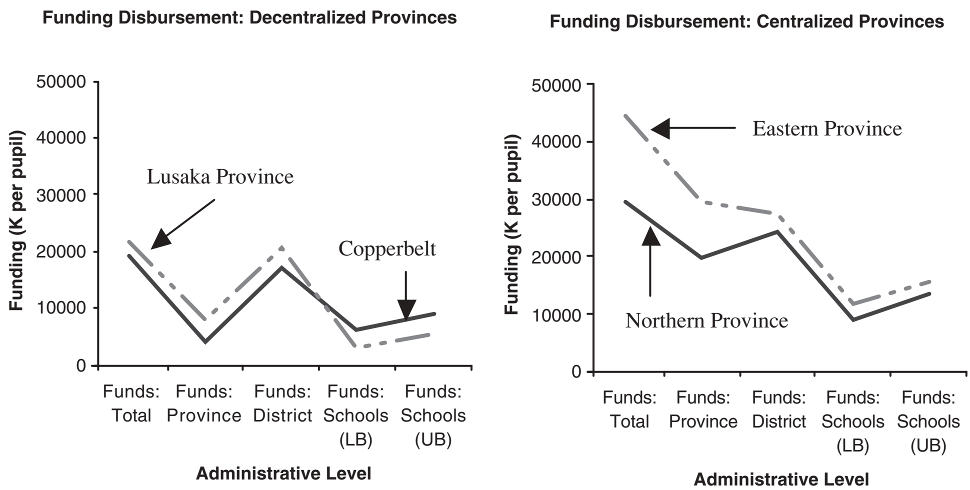
Leakages

Following the methodology used in Uganda (Ablo and Reinikka, 2000) we define leakage in the Zambian educational system as the ratio of what schools actually receive to what they were supposed to receive. The exact equivalent of the per pupil funding in Uganda is the fixed-school grant in Zambia. We thus define:

The Zambia ESDS went beyond an estimate of leakage based on allocated funds. Specifically, it used an innovative approach to provide a complete picture of the funding

58. This, in itself, might not necessarily be a bad thing as we could be observing a shift of responsibilities from the provincial to the district level. For example, an increase in the number of vehicles at the district level in decentralized provinces would naturally increase levels of expenditure; and an increase in school inspection visits by district officials might not be recognized as an increased "funding" by individual schools as the latter might only interpret increased receipts from the district by goods/funds received and not necessarily the services provided by the district education office.

Figure 6. Funding Disbursement in Zambian Education



of educational institutions that examines all sources of funding for the school instead of restricting attention to those components that are clearly defined with an allocation rule. Thus, in the case of discretionary components where this methodology fails (since there is no rule about the amounts that schools are supposed to receive in the first instance, it is not possible to determine what constitutes "leakage" in the system) the ESDS tracked the amounts that schools receive, and then directly examine the equity implications of such allocations. The section on leakage establishes the following:

(a) For rule-based allocations to schools it was found that the Zambian educational system is working efficiently and there is little evidence to suggest that funds earmarked for disbursements are not reaching their intended beneficiaries. Specifically more than 90 percent of all schools (95 percent in all provinces except Lusaka) had received the rule-based allocation at the time of the survey and delays in disbursement rather than leakage of funds was a more likely explanation in the case of schools that had not received the grant (this grant was disbursed only one month prior to the survey).

(b) For rule-based allocations to teachers, it was found that salaries and clearly defined allowances are disbursed efficiently. There is some evidence of delays in the updating of the payroll system as well as significant arrears in the case of allowances that are not clearly specified. Hence in the case of salaries 95 percent of all teachers had no outstanding amounts. For allowances where there is a clear specification based on location (hardship allowance given to teachers in rural locations) or status (teacher-trainee allowance), less than 15 percent of all who were supposed to receive the allowance were overdue by six months or more. However, in the case of overtime allowances (which must be filed every term) and allowances that resulted from a change in the status of the teacher (such as added tasks with commensurate allowances) this percentage jumps to 50 percent. For all allowances there is considerable evidence that lags in updating the payroll regularly result in delays of 1–3 months in payment.

(c) Turning to discretionary allocations to schools it was found that the positive results obtained earlier no longer hold—less than 20 percent of schools receive any funding at all from discretionary sources combined. The crucial importance of rule-based funding at the level of the school is also highlighted by the change in the relative shares by sources as we move down the administrative hierarchy—at the level of the province, the share of rule-based funding ranges from 8 percent to 40 percent with a median of 12 percent. Moving down to the districts, this share increases to between 19 percent and 63 percent with a median of 44 percent. Finally at the level of the school, this share ranges from 1.6 percent to 100 percent with a median of 99 percent- more than 75 percent of all schools have received cash resources only from rule-based sources in the current year.

(d) Similarly, for teachers there are substantial amounts overdue through one-time benefits and payments and in some province the overdue amount accounts for three times the monthly salary of the teacher.

(e) The survey also found that the discretionary funding that is eventually disbursed to schools is disproportionately large compared to rule-based funding. Conditional on a school receiving such funding, it could account for as much as 60 times what it would get under the fixed-allocation grant.

(f) This difference suggests that discretionary allowances may be earmarked for certain kinds of expenditures that require very large outlays. This is confirmed through an analysis of spending at the level of the school it was found that most discretionary funding is associated with infrastructure. A simple bivariate correlation confirms a high degree of association (0.53) between per pupil spending on infrastructure and discretionary funds received.

(g) There are thus two potential explanations for the patterns of discretionary funding and school expenditure based on a distinction between recurrent and capital expenditure.

   (i) One potential explanation is that schools are provided discretionary funds for capital expenditure on a rotating basis. Thus if a school were "rehabilitated" every ten years we would only expect to find 10 percent of schools in any given year receiving money for capital expenditures. In addition, the amounts of such expenditures received would be very large compared to amounts received for recurrent spending. According to this hypothesis the pattern of funding and expenditure that we observe is a reflection of the 'lumpy' nature of infrastructure investment.

   (ii) A second explanation could be that since rule-based funding is clearly defined with a simple allocation rule, it is extremely difficult for any political economy considerations (such as "capture" of funds by elites) to impact on school allotments. On the other hand, discretionary funding is not associated with any such rule. The pattern of funding that we observe then is a reflection of the difference between rules and discretion- the few schools that receive large amounts are "special" schools that have greater bargaining power with the higher levels of the administrative structure.

The analysis of the equity dimension of education expenditure in section D discusses this concern and relies on the following observation: if the first explanation is correct it is unlikely that the flow of discretionary funds to schools will be correlated with wealth. If schools are provided with infrastructure funds on a rotating basis, it seems natural to assume that the sample of schools receiving such funding will be a mix of schools in rich and poor areas. Consequently, systematic differences in funding by wealth levels would lead us towards an explanation based on the difference between rules and discretion, rather than one based on a sole distinction between capital and recurrent expenditures.

Equity

As with the previous sections, the ESDS examined funding-equity in the Zambian educational system separately for rule-based and discretionary allocations and focused on the relationship between funding and three related variables:

- Urbanization: Do urban schools/urbanized districts receive more than their rural counterparts?
- Wealth: Do richer schools/districts receive more than their poorer counterparts?
- Distance to Administrative Offices: Do schools that are closer to administrative offices receive more than those that are further away?

The main findings are summarized below:

(a) Rule-Based funding is highly progressive with greater per pupil amounts allocated to less urban and poorer schools and districts. Given that there is no evidence of leakage, one can see that the equity aspects of rule-based funding will depend (both at the district and the school level) on the relationships between school size and these three variables (recall that the rule-based component of funding is a per-school grant of US$600 or US$650). First, at the district level, those with smaller average enrollments will receive higher funding. To see this consider two districts each with 100 schools but average enrollments of 50 (District A) and 100 (District B). Since the rule-based allocation is a fixed per-school grant, both districts receive exactly the same allocation. However, since district A has a smaller number of students than District B, the average per pupil grant will be much higher in District A compared to District B. At the school level, exactly the same reasoning applies—schools with higher enrollments will receive less per pupil funding than those with low enrollments. Table 19 below shows how enrollment relates to the three variables of interest:

(b) The table shows that bigger schools tend to be richer (high enrollment schools are more than one standard deviation richer), more urban (82 percent of all high-enrollment schools are urban compared to 5 percent of all low enrollment) and closer to administrative offices (62 percent of all high-enrollment schools are less than 5 km from the district office). Hence, we would expect to find that their per pupil rule-based allocation is lower than their rural and poorer counterparts.

Table 16. Enrollment, Urbanization, Wealth, and Distance

Level	Urbanization, Wealth and Distance	Low Enrollment Schools	Medium Enrollment Schools	High Enrollment Schools
District Level	Average District Wealth	–0.52	0.14	0.67
	Schools in Urban Locations (%)	2%	4%	66%
School Level	Average Enrollment	275	719	1695
	Urban Schools (%)	5%	25%	82%
	Schools less then 5 km from district office (%)	4.84%	22.11	62.3
	Schools less than 5 km from provincial office (%)	5.2	13.1	21.5
	Average Wealth Index	–0.66	–0.07	0.75

Source: Education Service Delivery Data.

(c) Thus the poor schools receive four times the rule-based allocation of rich schools and rural schools receive three times the allocation of urban schools.

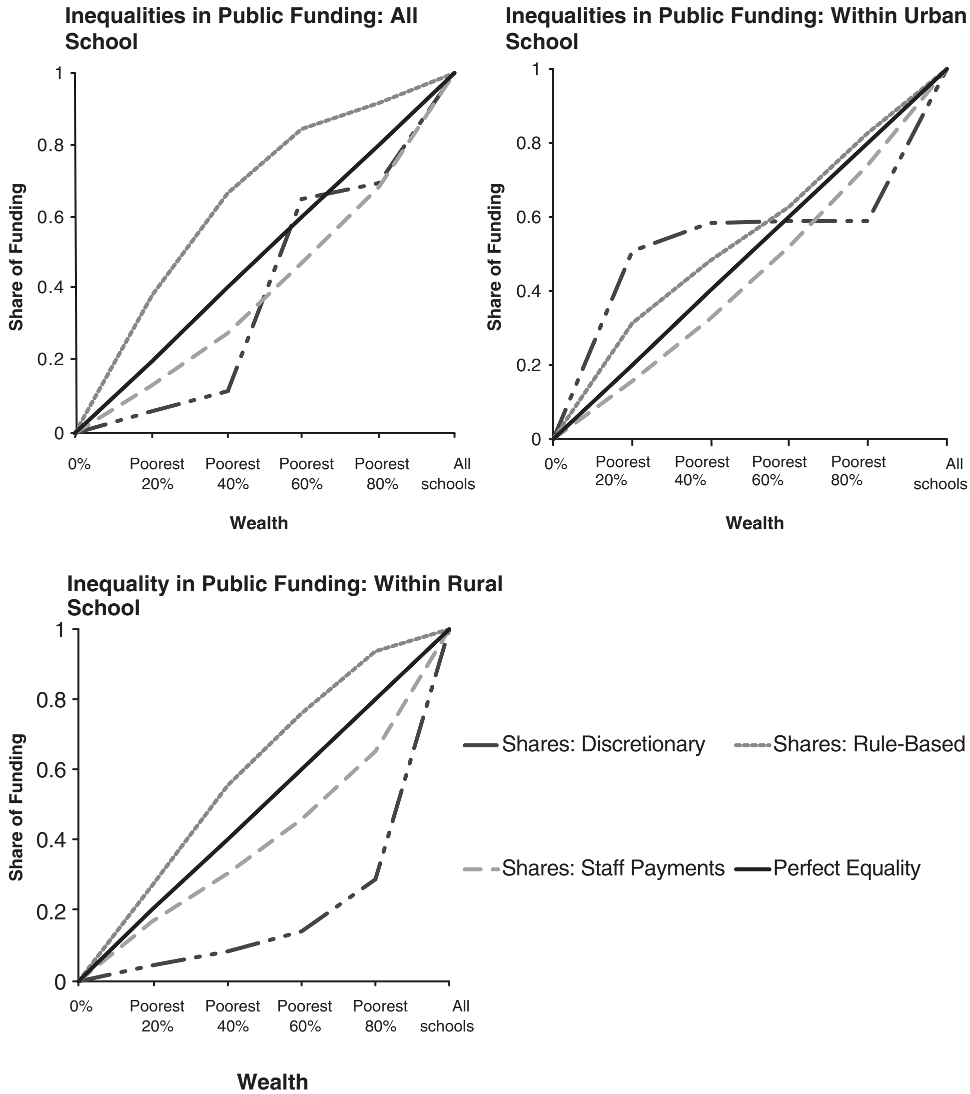
(d) In fact, the findings suggest a disturbing trend: when tracking expenditure to the districts, provinces allocate discretionary funding only slightly more to poorer districts. As a result, for total receipts at the district level the progressive nature of funding patterns is retained, albeit smaller than what it would be under rule-based funding only.

(e) Any discretionary funding in rural schools has a very high probability of being disbursed to wealthier schools, while within urban schools allocations are wealth neutral. Because the monies disbursed are orders of magnitude higher compared to the rule-based allotment, the progressive nature of the rule-based allocations disappears—at best, funding that flows from the district to the school is wealth neutral (with no significant differences in received amounts across rich and poor schools), and at worse it is regressive for rural and progressive for urban schools.

(f) This arises primarily from higher class sizes and the greater use of trainee-teachers in rural locations. Hence, once we factor in staff compensation, the results show that the only progressive component of the Zambian education system is the rule-based allocation. Once per pupil teacher funding is added in, the entire education funding system becomes regressive with poorer schools (K14,531 per pupil) receiving less than richer schools (K19,826 per pupil).

These findings are summarized in the graphs of funding inequality (Figure 8) below. The horizontal axis in the funding inequality graphs is the wealth distribution and the vertical axis is the share of public funding that each group receives. Each curve in the graphs shows the share of public funds that accrues to (for instance) the poorest X percent of the popu-

Figure 7. Inequalities in Public Funding in Zambian Education



lation. The "line of perfect equality" is then the diagonal that shows funding shares if all funds were distributed equally among the population.

These figures clearly demonstrate the findings of this section:

(a) Rule-based funding is always progressive with higher shares for the poorer sections of the population (the curve always lies above the diagonal so that (for instance) in the entire sample, the poorest 20 percent of the population receives 38 percent of all rule-based funding). Moreover, such funding is progressive not only in the entire sample of schools, but also within urban and within rural schools.

(b) Staff Compensation is always regressive, with the curve lying below the diagonal for all three samples (the entire sample, and within urban/rural).

Finally, discretionary funding is regressive in the entire sample as well. However once we look at such funding within urban/rural schools we find that within urban schools discretionary funding is progressive while within rural schools it is regressive

This then opens up the question of household inputs into education- if there are huge funding differentials between schools (for instance, the rule-based component implied that per pupil funding could vary from K1,889 to over K8,000 depending on the school), and some schools receive a lot less than others, do households adjust their own contributions to account for the level of school receipts from the public funding system? If yes, how does this household spending impact on funding equity in the Zambian educational system? We present some preliminary results on this question from our household survey that complements our construction of the public expenditure system.

Private Expenditures

The issue of school funding from household contributions is at an important crossroads in Zambia. Anecdotal evidence from a number of studies during the 1990s suggested that schools had started charging high Parent-Teacher Association (PTA) fees and a concurrent decline in net enrollment during the same time period led to an association between enrollment and high PTA fees. Consequently, in April 2002 (three months prior to the fielding of the ESDS) PTA fees were abolished for primary and basic schools (although secondary schools could and do continue to charge fees) and the government reiterated its commitment to free education. With this background in mind, our key findings regarding private expenditures are as follows.

(a) The announcement has had the desired effect with PTA fees decreasing to less than 30 percent of their Year 2000 values, although this decline is concentrated primarily in the urban areas of Lusaka and Copperbelt. In addition, the ESDS found that the gradient between PTA fees and school wealth declined sharply during the same period.
(b) Consequently, for all provinces, but especially for Eastern and Northern, public funds are the most important source of financial flows to the school; thus public funds comprise 96.3 percent of the total funding of the school in Eastern province (the most reliant on public funds) and this decreases only to 81.6 percent for Lusaka (the least reliant).
(c) The decreased importance of household contributions to school funding would suggest that the addition of such sources of funds should not alter or significantly exacerbate results regarding the regressive nature of school funding obtained in the previous section. Thus, for instance, the difference between schools with poorer and richer households in private contributions to schools is K1,300 per pupil, but for public funding this increases to K3,100. Similarly, schools that are closer to the district office raise K300 more per pupil, but this difference is dwarfed when compared to the K8,200 difference in public funds within the same categories. Conse-

quently, the addition of private contributions to schools in educational funding leaves unaltered our basic equity results and does not exacerbate differences in funding between rich and poor schools by any significant amount.

(d) However, to examine only private contributions to school funds can be misleading if most inequality in private expenditure is at the level of the household, that is, through private, household level non-fee spending on children. An examination of such spending was based on a household survey carried out simultaneously with the ESDS.

(e) The household survey results show that non-fee expenditures on children are seven times the corresponding expenditure on fees, and are the main source of inequalities in private expenditure. The inclusion of private expenditure worsens the regressive nature of the public funding system: the poorer 50 percent of the population sees a decline in its share of educational expenditures from 40 percent to 34 percent once private expenditures are factored in the analysis.

(f) The examination of the degree of substitutability between private expenditures and public funding showed a strong relationship. Households decrease their own private expenditures when public funding increases.

The main findings on inequality in private funding are summarized in the two graphs below.

Figure 9 plots the funding per pupil from public non-salary funds, public salary funds and private fee and non-fee expenditure against wealth quintiles. As is clear from this figure, the major sources of funding in this sample of schools are public non-salary funds and private non-fee expenditure. Figure 10 then plots the funding-shares graph for public and private funding, where the horizontal axis represents the share of the population and the

Figure 8. Equity in Public and Private Funding

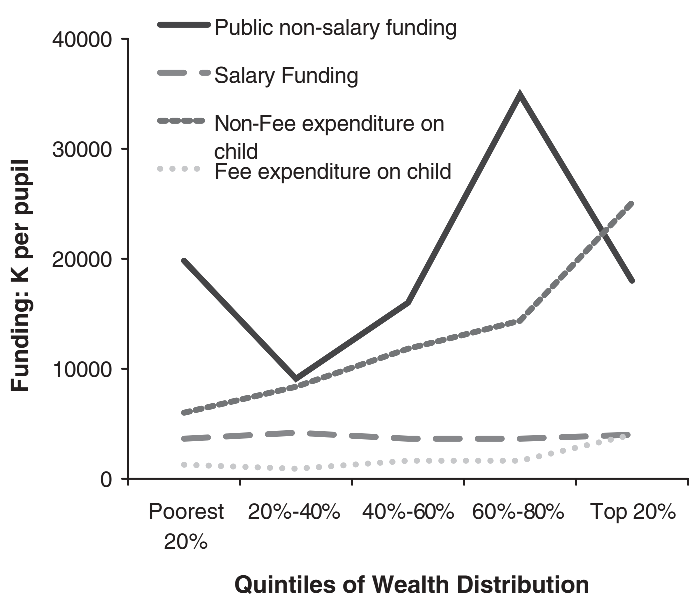
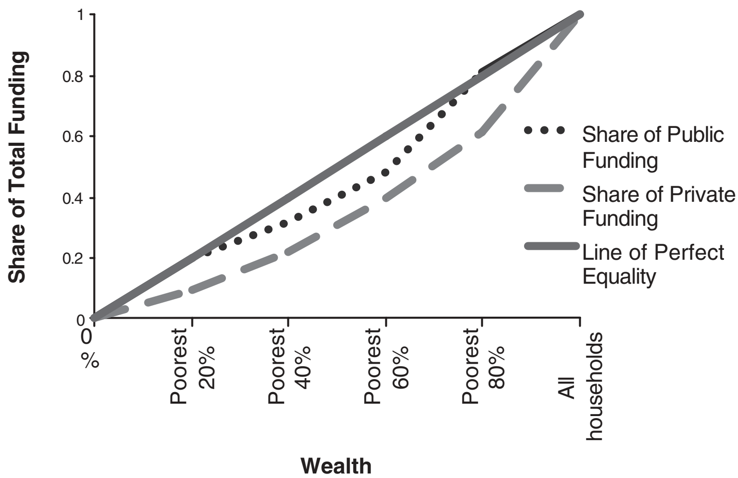


Figure 9. Lorenz Curves of Public and Private Funding



vertical axis the share of funding as before. This figure demonstrates that while there is inequality in both public and private funding, inequality in the latter dominates that in the former with the funding-share curve always lying further below the diagonal.

Discussion and Conclusions

This ESDS makes three contributions to our understanding of educational funding in the Zambian context. The first is to show that funding characteristics are closely linked to the type of funding that is disbursed. In the case of rule-based funding, the Zambian educational system works efficiently and there is no evidence that such funds are diverted from their stated purpose. For discretionary funding however, the majority of such funds are spent at the district and provincial levels, and the rest is allocated to less than 20 percent of all schools.

The second contribution is the analysis of funding equity using the wealth of pupils in the school. The specific rule used in the case of rule-based allocations has led to greater per pupil funding for poorer and more rural schools. However, these allocations are the only progressive disbursements in the ESD survey. Per pupil staff allocations are higher in urban and richer schools. The evidence on discretionary allocations suggest that higher disbursements to richer schools within rural areas and wealth-neutral allocations within urban areas. Once all sources of public funding are factored in, public school funding in Zambia is regressive with almost 30 percent higher allocations to richer schools.

The third contribution is to show how private expenditure at the level of the household impacts on equity in educational funding. Non-fee expenditures incurred by households on children, rather than contributions to school funds through PTA and other fees, are the major source of inequalities in the current environment. Moreover, households tend to decrease such private contributions when public funds to the schools increase.

These findings would suggest that a greater percentage of all funding should be allocated on a rule-based basis to ensure that schools receive a larger share of funds in the system. It was initially thought that the process of decentralization would partially fulfill this need- since more money would flow directly to the districts; accountability and therefore disbursements would be higher. Unfortunately ESDS did not find strong evidence of this happening. Decentralization seems to have only shifted spending from the province to the district, and in terms of funding equity; it is precisely at the district level that richer schools are receiving higher discretionary funds than their poorer counterparts.

However even if rule-based funding were to be increased, there would be two subsidiary implications that would have to be carefully evaluated. First, the current rule-based allocation has the implication that schools would fare better in terms of per pupil funding if they could decrease their enrollments. The more common school fund rule is based on funding that is directly proportional to the number of enrolled children. There is no guarantee that this would work as well as the current, unambiguous rule. One suggestion therefore would be to continue with the current rule (which also has the desired equity implications) but to monitor enrollment carefully through the regular data collected both administratively and periodic surveys such as the Zambian School Census.

Second, when public funds to schools increase, this crowds out private spending. While the results presented here are preliminary, there is evidence that this crowding-out can be fairly large. Thus, public funds may be far more effective at addressing inequalities across rather than within villages- this would suggest targeting at the level of schools with greater funding to poorer regions.

PART IV

Summary and a Program of Priority Actions

CHAPTER 9

A Program of Priority Actions

Thus far, the report has discussed specific actions to address issues related to public expenditure management, procurement, and financial accountability with a view to improve poverty reduction outcomes. While these actions are inter-related, their implementation has to be sequenced carefully taking into consideration the country's capacity, scarce resources, and the overall socio-political environment. This chapter discusses the vision that the Government aspires to in the medium term and, in that context, a program of priority actions that would enhance Zambia's accountability, transparency and predictability in public spending. It lists specific policy actions for each of the next three years, and builds upon measures proposed in the HIPC assessment and action plan (AAP) in 2001. It is proposed that during the first year, donors will provide specific financial and technical assistance either through a pooled arrangement or individually. As GRZ PEMFA capacity increases, it is expected that financial aid could increasingly be channeled through the budget, and that by the end of three years, a significant proportion of donor funding could be provided in the form of budget support, in the context of the Poverty Reduction Support Credit (PRSC).

Zambia is at a crossroads. The credibility of the public spending is at stake both internally and externally. Internally, the cynicism regarding the budget and its lack of impact on poverty is widely shared by the public, while externally the support of donors is waning reflecting the doubts and difficulties that donors have had in tracking budget implementation. The new administration has recognized this excellent and unique opportunity to reverse this dangerous trend through embarking on PEMFAR reforms. At a time of diminishing resources, there are important financial gains from undertaking these reforms. As shown in the annex on procurement, the savings from procurement alone could add up to US$50 million. Other gains and increasing support from donors could add up to twice or three times that amount.

Medium-Term Vision For Zambia

Before discussing in detail the recommended program of priority actions, it is important to specify what the outcome of the PEMFA reform program would look like in the medium term (for example, after five years of reforms.) First, the budget would be prepared in full consultation with the technical ministries, and in a medium-term (three-year) framework where implications on future recurrent expenditures of the existing budget are made explicit. The budget would make explicit all transfers to other levels of the government and other entities such as parastatals. The budget would include both current spending as well as capital spending, and projections on these would be supplied by donors on a regular and accurate basis. The budget would reflect what has been agreed in the context of the PRSP. It would be classified correctly, and one could trace where the money goes through the system. There would be a high level of predictability in the flow of funds to ministries and to spending units. Commitment control would be fully instituted and monitored on a weekly basis. Arrears would have been paid off and no new arrears would be emerging. The budget outturn would come very close (90 percent) to the plan, both in aggregate and by sector and subsector. Consequently, there would be zero, or very limited supplemental appropriation. Internal reports would be received within four weeks. Audited accounts would be presented within six months. Wages and non-monetary awards of civil servants and public sector employees would all be consolidated and the wage bill would now accurately reflect, to a large extent, the explicit as well as the implicit compensation packages for the employees. Parliament and other development partners would be involved both in budget preparation and execution. Procurement would be undertaken efficiently and timely: up to 80–90 percent of procurement undertaken at the line ministries instead of at the National Tender Board; both processing time and corruption will be significantly reduced.

Achievement of this medium term vision will require implementation of all the recommendations in this report. But it is important to sequence and prioritize the policy actions discussed below to achieve the above goals in accordance with the capacity and resources of the country and this chapter therefore seeks to identify the priority actions over each of the next three years that will be necessary to make steady and significant progress towards achieving the vision. Actions can be classified into the following broad categories: (i) measures to restore the credibility of the budget through improving coverage, preparation, predictability and execution of the budget; (ii) measures to improve budget reporting and monitoring; (iii) measures to improve procurement; iv) measures to improve financial accountability; and (v) supporting measures to ensure that PEMFA measures work.

The Three-Year Program

At the PEMFAR workshop held in September 2002, it was proposed that a joint GRZ/ Donor Steering Committee be set up to direct the PEMFAR reforms and to ensure that these reforms will be implemented properly and in a timely fashion. It is proposed that the Steering Committee be chaired by the Secretary to the Treasury. The main champion for leading the implementing of the reform could be the Secretary to the Treasury, MFNP. There will also be a Secretariat. This Secretariat should be in charge of costing each of the above measures and of coordinating with donors in order to gather financial and technical support for implementation.

To achieve the above objectives, the following measures, grouped by broad categories, need to be taken over the three-year period. For convenience, these measures are separately presented for each of the three years.

Table 17. First-Year Priority Actions

	Recommended Action	Institutional Responsibility
	Legal Framework and Parliamentary Oversight	
Legal Framework	Revise the legal framework for financial management to require that: a) the budget be submitted to Parliament with sufficient time [e.g., 60 days] to review and enact it before the start of the fiscal year, b) Parliament approve any supplementary estimates before the spending occurs, c) emergency expenditures be made through a voted Contingency Fund only, d) the amount of time allowed for submitting an excess (unauthorized) expenditure bill be reduced, and e) the financial statements be submitted to Parliament within 6 months of the end of the fiscal year.	TBD
Parliamentary Review	Strengthen Parliamentary Oversight over spending by: a) improving the budget presentation (as described below under budget preparation), b) presenting to Parliament the macro framework and functional priorities of the budget earlier in the budget cycle	MFNP, Parliament
	Budget Preparation	
Credibility of the Budget	Reconcile the large variances between budget estimates and actual expenditures for each budget head and subhead, and assure that the proposed budget reflects either the higher cost or specific policy action taken to reduce future services.	MFNP/ Budget Office
	Develop a multi-year planning framework (or MTEF) by building on the recent budget framework paper to (a) link national development priorities (TNDP/PRSP) to annual budgets, (b) to reconcile the differences between budget estimates and actual program costs., and (c) to engage Cabinet and Parliament earlier in the budget calendar.	MFNP, Cabinet, Parliament
	Reduce the amount of supplementary appropriations, so that they are used only in exceptional circumstances [e.g., 5% of the original budget].	MFNP
Classification	Enforce the correct economic classification of expenditures under the existing system	MFNP
Presentation	Improve budget presentation by including: (a) columns with comparative expenditure data by head and subhead for the two years prior to the budget year, (b) summary information on the status of capital projects (e.g., original budget amount, expenditures to date, and balance), (c) summary tables of spending by category, and (d) narrative on major policy changes reflected in the budget.	MFNP, Parliament

(*continued*)

Table 17. First-Year Priority Actions (*Continued*)

	Recommended Action	Institutional Responsibility
	Budget Execution	
Cash Management	Establish clear institutional responsibility for cash management within the MFNP	MFNP
Cash Management	Continue to publish information on cash releases as a means of promoting transparency.	MFNP
Cash Management	Implement Quarterly Cash Flow Plans that (a) are based on comprehensive revenue forecasting and an assessment of seasonal expenditure requirements and (b) that provide an assurance to line ministries as to the level of commitments that they can enter into.	MFNP
Commitment Control	Establish commitment ceilings for ministries based on the quarterly cash flow plans and enforce compliance with monthly outturn reporting. Apply sanctions in cases of persistent non-compliance.	MFNP/ Budget Office
Commitment Control	Complete and maintain the domestic arrears database, and develop a plan for liquidating past arrears.	MFNP
	Public Procurement	
Procurement	Establish a Procurement Reform Implementation Unit in the MFNP.	MFNP
Procurement	Establish a procurement cadre under ZNTB.	ZNTB
Procurement	Finalize the plan for delegation of procurement authority to ministries/ agencies in 3 years.	MFNP, ZNTB
	Accounting, Reporting, and Auditing	
IFMIS	Procure hardware and software for the IFMIS, pilot test, evaluate.	MFNP
External Audit	Remove the OAG's budget and staffing policies from control of the Executive and place them under the responsibility of an independent Audit Board (an oversight body), which in turn reports to Parliament.	Parliament, State House
	Human Resources	
	Complete the payroll data cleaning exercise and retrenchment packages, and use the savings to off-set the cost of the 2003 salary increases.	PSMD

Table 18. Second-Year Priority Actions

	Recommended Action	Institutional Responsibility
	Legal Framework and Parliamentary Oversight	
Parliamentary Review	Strengthen Parliamentary Oversight over spending by assuring that Parliament provides adequate funding for the Budget Estimates and Public Accounts Committees.	MFNP, Parliament
	Budget Preparation	
Credibility of the Budget	Develop a multi-year planning framework (or MTEF) by building on the recent budget framework paper to (a) link national development priorities (TNDP/PRSP) to annual budgets, (b) to reconcile the differences between budget estimates and actual program costs., and (c) to engage Cabinet and Parliament earlier in the budget calendar.	MFNP, Cabinet, Parliament

(*continued*)

Table 18. Second-Year Priority Actions (*Continued*)

	Recommended Action	Institutional Responsibility
Classification	Expand Activity Based Budgeting (ABB) to all ministries and integrate the classification system into the cash release process and into the accounting system, so that it becomes the primary basis of budget preparation, budget execution, and reporting. Use this to identify and monitor poverty-reducing expenditures in the budget.	MFNP
	Budget Execution	
Commitment Control	Strengthen the Commitment Control System to (a) maintain timely and reconciled information regarding commitments and payments, and (b) to prevent any payments from being made unless commitments were properly recorded in the expenditure ledger. Apply sanctions in cases of persistent non-compliance.	MFNP/AccG
Payroll controls	Update payrolls more effectively by having the senior pay point officer check and sign off on the payroll lists each month and return them to the provincial headquarters. These verified payroll lists should serve as the basis for updating the payroll master file.	MFNP
	Develop unique codes for each post in the establishment registry and use them to control unauthorized additions to the payroll database.	PSMD
	Public Procurement	
	Enhance the regulatory and supervisory functions of ZNTB.	MFNP, ZNTB
	Revise the legal framework.	MFNP, ZNTB
	Introduce an improved registration list system. Improve procurement practices, through greater restriction of negotiation and informing tenders.	ZNTB
	Accounting, Reporting, and Auditing	
Accounting & Rptg	Modify the accounting procedures in order to capture commitments and arrears, and to highlight interest charges and penalties on capital projects.	MFNP
	Clarify the role and responsibilities of the Accountant General in legislation, and have the office report directly to the Secretary to the Treasury.	MFNP
	Ensure that LPOs and contracts are entered into the FMS at the time the commitment is entered into and not at payment stage.	MFNP
	Reconcile expenditure returns with budget releases and banking formation for each ministry to verify compliance with financial regulations.	MFNP
	Submit audited financial statements to Parliament within 6 months of the end of the fiscal year.	
IFMIS	Roll out IFMIS to all ministries and train users.	MFNP
Internal Audit	Increase the capacity of Internal Audit to execute its annual workplans through improved staffing, greater operating resources, and better coordination with the Office of the Auditor General (OAG). Workplans should include materiality audits of capital projects.	MFNP
	Hold Controlling Officers responsible for reporting on how IA recommendations are being followed-up.	MFNP
	Human Resources	
	Rationalize the pay structure by substantially reducing the proportion of salary paid as allowances in 2004.	PSMD

Table 19. Third-Year Priority Actions

	Recommended Action	Institutional Responsibility
	Legal Framework and Parliamentary Oversight	
Parliamentary Review	Strengthen Parliamentary Oversight over spending by: (g) Submitting regular (e.g., semi-annual) reports on the execution of the budget accompanied by any requests for supplementary estimates; (h) Developing arrangements to ensure government response to PAC reports	MFNP, Parliament
	Budget Preparation	
Credibility of the Budget	Develop a multi-year planning framework (or MTEF) by building on the recent budget framework paper to (a) link national development priorities (TNDP/PRSP) to annual budgets, (b) to reconcile the differences between budget estimates and actual program costs., and (c) to engage Cabinet and Parliament earlier in the budget calendar.	MFNP, Cabinet, Parliament
	Improve comprehensiveness of the budget by reporting on quasi-fiscal activities including revenues and expenditures of BOZ, state-owned enterprises, pension funds, and other extra-budgetary funds. Also begin reporting on major contingent liabilities.	MFNP
Capital Expd Controls	Institute a reporting mechanism between MFNP and MWS that provides detailed financial information on each capital project including the financial terms of the contract, work variations, price fluctuations, interest penalties, etc., in order to inform cash release decisions by MFNP.	MFNP, MWS
	Assure that recurrent costs of capital projects are adequately planned for in the MTEF, as a pre-condition to the project being started.	MFNP
	Public Procurement	
	Improve business practice through development of a code of ethics, training, and development of competition and fair trade regulation	MFNP, ZNTB
	Improve trade practices through increased capacity of customs department	ZRA
	Accounting, Reporting, and Auditing	
IFMIS	Roll out IFMIS to all ministries and train users.	MFNP
Internal Audit	Carry out a comprehensive assessment of the control system and recommend corrective actions.	MFNP
	Carry out a comprehensive assessment of the control system and recommend corrective actions.	MFNP
External Audit	Expand the OAG's responsibilities to include performance audits.	Parliament, State House
	Human Resources	
	Continue decompressing salaries to enhance pay for professional and skilled technical personnel that the Government has most difficulty in attracting and retaining.	PSMD

Progress Monitoring

To ensure that the above measures will be properly implemented in a timely fashion, progress will need to be monitored closely according to a number of indicators proposed below. The indicators must be chosen on the basis of the following criteria: (i) selectivity since the fewer indicators, the better; (ii) they focus more on outcome rather than process, that is, indicators showing that performance of the budgetary system has improved, rather than actions have taken place; and (iii) they can be readily measured. An indicative list of performance indicators is given below.

Credibility of the budget
1. Variance between budget estimates (Yellow Book) and actual expenditure.
3. Number and level of supplementary estimates.
Comprehensiveness of the budget
4. Level of off-budget expenditures.
Linking policies and budgets
5. Preparation of background papers for Cabinet discussions of policy and program tradeoffs as part of the annual budget preparation.
Predictability of funds flow
6. Variance between the cashflow plans (or pro-rata allocation of the total budget if cashflow plans are not available) and the actual cash releases (in timing and value).
Expenditure control
7. Level of arrears
8. By sampling, percent of contract payments that are either: a) unpaid due to lack of commitment; or b) have interest penalty (because of delays in payment) of 50 percent or above of the original amount.
9. percent of invoices paid without funds

Costing and Support by Development Partners

Some of the policy measures above are essentially about the changing the way Government works, and do not require much financial support. Others, however, require technical and financial assistance from all development partners. Detailed costing of the financial and technical requirements for implementation of these reforms should be carried out jointly by the Government and donors. Once the program is fully costed, a pooled-funding arrangement could be developed by donors to support the program.

In the past, support by development partners of Zambia have not always been effective due to the lack of coordination and information sharing among donors. Therefore, it is proposed that the PEMFAR Secretariat be formed to support PEMFAR The Steering Committee, discussed above, should hold regular briefings meetings with donors in order to report progress and to resolve any issues arising from implementation. Formal assessment of PEMFAR progress, including a formal report, can be carried out on an annual basis and should involve all donors.

ANNEXES

ANNEX A

Comparative Review of the Role of Parliament in Budget Passage

The tables below are drawn from research by Hallerberg, Strauch, and von Hagen and show how Parliament's power to change the Government's budget varies across West European countries. In a separate commentary, Hallerberg has noted that amidst the variation, there is an observable pattern:

> Legislatures are most powerless in countries that traditionally have few social divisions. These countries also have one-party majority governments. Greece and the United Kingdom are prominent examples. Legislatures play more prominent roles in societies with many social divisions. Germany and the Netherlands are examples. Countries with both weak parliaments can have good fiscal performance.[59]

59. Unpublished paper prepared for the World Bank South Asia Region PREM, March 2003, "Executive-Legislative Relations and the Budget: Promoting Efficiency and Accountability."

Where Parliamentary Powers Differ: Legislature's Ability to Change the Government's Proposed Budget
European Union Countries, 2001

Countries	*Amendments* Amendment Power	Amendments Limited	Amendments Offsetting	Propose Separate Budget	Legal Ability to Influence Budget
Austria	Yes	No	No	Yes	4
Belgium	Yes	No	No	Yes	4
Denmark	Yes	No	No	No	3
Luxembourg	Yes	Yes	No	Yes	3
Netherlands	Yes	No	No	No	3
Portugal	Yes	No	No	No	3
Spain	Yes	No	Yes	Yes	3
Sweden	Yes	No	Yes	Yes	3
Finland	Yes	No	Yes	No	2
Germany	Yes	No	Yes	No	2
Italy	Yes	No	Yes	No	2
France	Yes	Yes	Yes	No	1
Greece	No	Not relevant	Not relevant	No	0
Ireland	No	Not relevant	Not relevant	No	0
United Kingdom	No	Not relevant	Not relevant	No	0

Note: A country receives a score of "1" on the parliamentary index for each of the following: amendments are allowed; they are not not limited; they are not offsetting; and parliament may propose its own budget.

Source: Data from Hallerberg, Mark, Rolf Strauch, and Jurgen von Hagen. 2001. "The Use and Effectiveness of Budgetary Rules and Norms in EU Member States." Prepared for the Dutch Ministry of Finance.

Where Parliamentary Powers Are Similar: Simultaneous Treatment of Expenditures and Revenues, Time Limits, and Actual Changes to the Government's Budget
European Union Countries, 2001

Countries	Expenditures and Revenues Treated Simultaneously?	Time Limit on Budget Passage?	Estimate of Total Size of Amendments, % GDP
Austria	Yes	Yes	less than .1%
Belgium	Yes	Yes	?
Denmark	Yes	Yes	less than .5%
Finland	Yes	Yes	less than .1%
France	No	Yes	Less than .1%
Germany	Yes	Yes	Far less than 1%
Greece	Yes	Yes	Not allowed
Ireland	No	Yes	Not allowed
Italy	Yes	Yes	extremely low
Luxembourg	Yes	No	0%
Netherlands	Yes	No	less than .1%
Portugal	Yes	Yes	–0.04%
Spain	Yes	Yes	0%
Sweden	No	Yes	less than .01%
United Kingdom	No	Yes	Not allowed

Source: Data from Hallerberg, Strauch, and von Hagen (2001).

b. The Rights of Members of Parliament in Budgetary Matters

Rights	Number of Countries
1. May reduce and increase expenditure and revenue.	32
2. May reduce but not increase expenditure.	17
3. May reduce expenditure, but only increase it with the permission of the government.	4
4. May reduce and increase expenditure if alternative provisions are made elsewhere.	13
5. Rights not specified.	15
6. Not applicable (Nicaragua).	1
Total	**82**

Source: Krafchik, Warren and Joachim Wehner, Institute for Democracy in South Africa (IDASA), "The Role of Parliament in the Budgetary Process." (1998). Originally drawn from the Inter Parliamentary Union, Parliaments of the World. A Comparative Reference Compendium (2nd edition), Aldershot (Gower), 1986, Table 38A.

ANNEX B

Government Banking Arrangements

Analysis of the Problem

As recently as three years ago, there were roughly 1200 Lusaka-based government bank accounts kept mostly in commercial banks. In addition, there were another 300 accounts in the provinces. Although the practice had been initially encouraged by BOZ so that it could avoid over-involvement in retail banking, eventually it became clear that it was having very negative repercussions on the government, and indirectly on the BOZ itself. Since 1996 the IMF has made recommendations to the government to improve performance in this area. One of the first tasks proposed was to conduct a census of such accounts in order to determine how many existed. In addition to reducing the number of such accounts, the Fund has also been concerned to ensure that all cash is routed through the BOZ and that receipts are credited promptly to the BOZ account.

The proliferation of commercial bank accounts had been problematic at least in part because of the large holdings of government monies that were being held in the banks for days or weeks without interest. In fact, not only were government resources not earning interest, but the government was paying fees and commissions on each of the active accounts. Worse yet, with resources scattered over a large number of accounts in different banks, some accounts would accumulate idle cash balances while others would be starved for cash. In the latter case, this would necessitate unnecessary borrowing by the Treasury. During this time ministries would have separate accounts for PEs, RDCs, capital, and revenue, plus multiple donor accounts and revolving funds. The cost to the government was also increased by the fact that government revenues transiting commercial banks in route to the BOZ were not being credited promptly to the government's account. Instead commercial banks were enhancing their liquidity from the extended floats and the government's interest-free money.

Substantial progress has been made in consolidating multiple ministry accounts into a single bank account per ministry, but the total number of government bank accounts still remains high. As the IMF noted during its 2001, the multiple bank accounts "essentially serve as a substitute for timely accounting." Of the various accounts that line ministries will have, the most important by far are the "mirror accounts" (used to pay RDCs and capital expenditure) and the salaries accounts. The operating procedures vary for each of these two categories of accounts. In the case of PEs, when MFNP authorizes a transfer of funds from control 99 account (at BOZ) into the control account of a given line ministry (also at BOZ), the funds are immediately transferred to the line ministries' PE account at a commercial bank. Salary checks issued by the line ministry on the commercial bank accounts are typically encashed within ten days of the transfer of funds from the BOZ. In contrast for RDCs and capital, line ministries must prepare a "cash backing sheet" each day, which lists the checks drawn. On this basis, BOZ transfers funds from the line ministries' control account to the line ministries' mirror account at the commercial bank.

Future Action Plan

As noted above, the IMF has taken the lead role among donors in providing advice to GRZ in reforming government's banking practices. The IMF recommendations from their June 2001 mission basically fell into five categories described below. Lowering the cost to government and improving the cash management capacity of GRZ are certainly two primary objectives, but not the only ones. Government should also ensure that the banks are financially sound, that there are uniform standards, and that the arrangements for monitoring the accounts are in place.

Centrally negotiate bank arrangements. MFNP, jointly with the BoZ, should solicit bids and negotiate banking arrangements with the commercial banks to agree on uniform terms for government business. Terms of such agreements should include a uniform fee schedule, a uniform rate of interest on the minimum average balance, and the responsibility of the banks for the issue of bank statements on time. Of course, some of the terms and conditions could vary across categories of accounts. Such reforms are needed because currently, each line ministry makes its own arrangements with commercial banks, and most of these arrangements are informal and are not defined in the form of written agreements or contracts. Consequently, government fails to obtain terms and conditions that are responsive to its needs and cost-efficient for the size and scope of its transactions with the banking sector. The new Accountant General has expressed an interest in 2002 in actively pursuing reforms in this area.

Create a Treasury single account (TSA) at BoZ. During the Fund's 2000 mission it recommended that the GRZ establish a TSA with the BoZ and use commercial banks on a zero-balance basis. Operationally what this means is that BoZ would notify commercial banks about funding limits for each mirror account but without remitting any funds. The commercial banks would in turn honor government checks up to, but not to exceed, the funding limit. At the end of each day, the commercial banks would submit details on government transactions to BoZ for settlement. The main advantage of this approach is that all government funds are concentrated in BoZ accounts, thereby facilitating government's cash management and reducing domestic borrowing needs. The implementation of a TSA could be facilitated if it is incorporated into the current design and planning of IFMIS.

Review and justify the utilization of all bank accounts. MFNP should review the need for each of the government's commercial bank account and consolidate them wherever possible.

Monitor bank accounts. The Accountant General Department should increase capacity to monitor commercial accounts on a monthly basis. This would include maintaining a database with account details: the account number and bank branch, the names of those authorized to operate the accounts, the balances, floats, and lags in reconciliation.

Review the definition of a government bank account. MFNP should work in consultation with BoZ and the commercial banks to agree on the list of government accounts at each commercial bank. In particular, MFNP should continue to de-link community-based accounts, which are sometimes mistaken by the commercial banks as being government bank accounts. As a result of this confusion there can be large variations between the consolidated position of government bank balances reported to the AG (by commercial bank) and the consolidated position reported in the monetary survey.

In addition to the above concerning government use of commercial bank accounts, the IMF has recommended that government continue its review and rationalization of the accounts at the BoZ, including the instruments of central bank credit to the government such as the forex bridge loan.

ANNEX C

Areas for Improving the Cash Release System

Good cash management or financial planning is critical to any organization of any size. Nevertheless, the Accountant General's office has cited some obstacles to this occurring in the public sector, including unimplementable budgets for some activities of government and the lack of material support (computers) for staff to work with. The Bank maintains, however, that these obstacles can be overcome and that cash management should become a regular part of the MFNP's activities. Cash management processes should be robust enough to deal with changing circumstances, including amended budgets. On the logistics side, PSCAP has already begun to procure computers to assist MFNP accounting staff in their various tasks. Moreover, the Bank can provide technical assistance to help the Accountant General's Office draw up procedures for doing some basic cash management procedures and training staff at an appropriate level. But MFNP should immediately assign responsibilities for developing cash management functions and working with the requisite technical advisors.

Part of the process for developing a cash management plan is soliciting input regarding the procurement and/or workplans of LMs. These should be core inputs to MFNP in determining its cash release priorities for a given period (e.g., Agriculture would get more during planting seasons). Furthermore, MFNP's goal should be comprehensiveness in its cash management, so that it is taking into consideration 100 percent of the forecasted resources for the period. The current system is based on planning for a given a percentage of budget—which may or may not bear any relationship to the forecast revenues for the period. Under the new system, funding for RDCs and grants may vary each quarter based on the revenue forecasted for that particular quarter, as well as consideration of debt servicing payments or contractual obligations on capital projects.

In its June 2000 report the IMF outlined characteristics of an effective cash system; the qualities noted then are fully consistent with the Bank's current proposals. It should:

- Be an enabling instrument of expenditure planning for spending ministries;
- Be forward looking—anticipating macroeconomic developments, yet capable of accommodating significant economic changes and minimizing their adverse affects;
- Be responsive to the cash needs of spending ministries;
- Be comprehensive, including all inflows of cash resources.

Improving transparency around cash release decisions has been a vital part of FSC and will continue to be stressed by the Bank. Indeed, providing clear information to line ministries and to the public on cash releases, serves a means to increase the accountability of MFNP Budget Office to execute the budget as it was intended by Parliament. If there are amendments to the budget approved by Parliament, or changes within the legal discretion of MFNP to make on its own, those can be disclosed as well in order to explain why cash releases vary from the original budget. MFNP has taken substantial steps in this area by publishing the cash releases each month in the local newspapers.

Renewed commitment by the authorities to implement the quarterly cash allocation plan is also required. Cash release decisions in Zambia are subject to considerable influence from other institutions, including some that maintain a higher political stature than MFNP. Consequently, the commitment to execute monthly cash releases according to a plan—and to not subject them to further ad hoc decisions—would require some consent and concurrence from these other institutions. The Bank believes that achieving agreement to be bound by a quarterly plan would be aided considerably by including other institutions in the formulation and/or approval of the plan. Input from ministries regarding their needs should be taken into consideration more systematically (as outlined above in cash management). Furthermore, the final arbitration of which institutions should be given the priority during a given period of the year transcends the authority of MFNP alone to decide. Although the Yellow Book should ultimately determine the cumulative amount that LMs receive over the year, the timing of those releases can be reasonably debated at Cabinet level prior to the quarter. Indeed, formulating a credible cash release plan will require input and commitment from other institutions besides MFNP. MFNP and Cabinet Office can begin immediately working together on drafting procedures and guidelines for how that decision making and debate would take place.

Annex Table C: Comparison of the 2001 GRZ Budget and Actual Funding

Agency	Variance: Actual vs. Budget				
	PEs (%)	RDCs (%)	Grants (%)	CAPEX (%)	TOTAL (%)
Administrative					
Office of the President—State Hse.	115917	295	–33	–100	279
National Assembly	7	–45	–45	1212	–9
Electoral Commission	–24	41		–100	39
Public Service Commission (OP)	36	38		0	34
Office of the Auditor General	–7	36	–94		21
Cabinet Office	73	42	98	61	43
Teaching Service Commission—OP	28	–5			7
Police & Prisons Service—OP	27	21		–100	21
Zambia Police—Min./Home Affair	35	31	130	18304	34
Commission for Investigations—OP	30	–7		–100	2
Ministry of Home Affairs	18	35	1892	–100	33
Ministry of Foreign Affairs	78	–32	103	–100	39
Judiciary	37	–23		–100	20
Ministry of Inform. & Broadcasting	–4	6	36	109	28
Public Service Manag. Div.—OP	–25	232	7	–41	3
Office of the Min. Without Portfolio	65	265		214	217
Permanent Human Rights Comm.	8	–28		7705	30
Ministry of Finance & Econ. Dev.	77	–6	25	156	18
Ministry of Sport	32	–15	73	–68	13
Ministry of Defence	85	407	121	21	141
Office of the President	145	712	444777	953	399
Ministry of Legal Affairs	–31	–32	–30	–65	–32
Anti-Corruption Commission	39	216		–100	49
Office of the President—Lusaka	32	–25		1380	52
Office of the President—Copperbelt	64	–28	–9	388	40
Office of the President—Central	34	–14		1665	91
Office of the President—Northern	–1	9		1521	71
Office of the President—Western	15	–27	–33	508	40
Office of the President—Eastern	20	–34		1124	29
Office of the President—Luapula	–11	–34	–33	2748	35
Office of the President—N. Western	45	–21		3743	60
Office of the President—Southern	20	–13		856	43
Total	55	58	38	282	57
Social					
Office of the Vice President	28	–15	168	12	116
Ministry of Health	45	27	5	67	29
Ministry of Labour & Social Securi.	145	–25	–29		–129
Ministry of Community Dvt	–13	6	–46	–100	–41
Ministry of Education	34	38	3	16	28
Ministry of Science & Techn.	–48	14	–9	–47	–10
Total	37	30	–3	–46	21

Annex Table C: Comparison of the 2001 GRZ Budget and Actual Funding (continued)

Agency	Variance: Actual vs. Budget PEs (%)	RDCs (%)	Grants (%)	CAPEX (%)	TOTAL (%)
Economic/Infrastructure					
Ministry of Energy & Water Dev.	–7	–24	–13	13	3
Ministry of Mines & Minerals Dev.	–11	1	–12	–80	–19
Ministry of Environ./Nat. Resources	47	–39	–34	269	21
Loans & Investments—MoLGH					
Loans & Investments—MoFED					
Ministry of Local Govt & Housing	–5	5	88	330	98
Ministry of Commerce, Trade & Ind.	–23	–2	31	–76	–25
Ministry of Communication	9	–54	–68	–38	–37
Ministry of Works and Supply	809	–13	0	61	50
Ministry of Tourism	81	–22	–77	–100	–61
Ministry of Lands	47	–29	–25	–100	–16
Ministry of Agriculture	105	–38	–45	14	21

ANNEX D

Procurement: Short-term Sequenced Actions

Procurement: Short-term Sequenced Actions

Issue	Recommended Action	Timing		Responsible
		From	To	
Establish Procurement Reform Task Force and an Implementation Unit	Appoint a High Level Committee, which will be responsible for initiating and overseeing the implementation of the activities in the Action Plan. The Committee must have high-level members from, for example, ZNTB, MOFNP, ACC, and AOG. The members should not be allowed to appoint substitutes. The Committee will be supported by a Procurement Reform Implementation Unit located in and responsible to PS Ministry of Finance and National Planning.	May 2003	May 2003	MOFNP
Finalize new decentralization plan	Develop plan for full decentralization of procurement in phases.	November 2003	February 2004	MOFNP ZNTB
	Appoint one or two provinces in first year as pilot provinces for full decentralization.	February 2004	April 2004	ZNTB
	Communicate plan to ministries and agencies and explain the plan's implementation and their responsibility.	February 2004	April 2004	MOFNP/ZNTB
Re-establish policy and supervisory role of the ZNTB as responsible for public procurement policy and regulation	Without waiting for new procurement legislation, prepare the structure of the ZNTB for this role and define the tasks.	December 2003	February 2004	MOFNP/ZNTB
	Prepare the budget for the ZNTB to carry out relevant role and ensure availability of funds.	December 2003	December 2003	ZNTB/MOFNP
	ZNTB to focus primarily on its policy and regulatory role immediately. Strengthen the department responsible for support to ZNTB for its regulatory functions, pending complete decentralization of ZNTB/CTC approval functions on procurement.	December 2003	January 2004	MOFNP/ZNTB
	Define and develop specialized functions matching tasks, such as monitoring of procurement, data collection on procurement activities, performance indicators and benchmarks, law drafting, drafting regulations and guidelines, and management and development of the cadre, and conduct outreach to private sector for closer involvement.	July 2004	October 2004	MOFNP/ZNTB

Revise legal framework	Revise terms of reference, already drafted in cooperation with AfDB, and clearly state that the revision of the procurement legislation should build on the UNCITRAL Model Law in terms of content and terminology.	November 2003	December 2003	ZNTB/MOFNP
	Develop new procurement law based on UNCITRAL Model Law that provides for the new procurement authority, complaints function, and a revised price preference system with more robust criteria.	March 2004	September 2004	DG ZNTB
	Develop Cabinet Paper for new legislation.	October 2004	November 2004	ZNTB/MOFNP
	Obtain Parliament approval of new legislation, set up ZNPA, and disband ZNTB.	January 2005	February 2005	MOFNP/ZNTB
	Develop new regulations based on the new procurement law.	March 2005	May 2005	DG of New Procurement Authority
	Develop new guidelines based on new law and regulations.	March 2005	May 2005	DG of New Procurement Authority
	Prepare new versions of standard bidding documents and incorporate anti-corruption clauses.	June 2005	October 2005	DG of New Procurement Authority
Establish the professional procurement cadre	Describe and define the cadre: level of skills for entry, code of conduct, salary structure, career path, and role of the cadre administrator (the procurement authority).	December 2003	March 2004	ZNTB
	Develop secondment system for the procurement cadre based on attractive salary system, administered by the procurement authority to replace the current system of mixed civil servants and personnel seconded by ZNTB.	March 2004	June 2004	ZNTB
	Develop HR database with the curricula of cadre members and those applying for entry.	July 2004	September 2004	ZNTB
	Identify and register cadre members who can enter the cadre without further training.	July 2004	September 2004	ZNTB
	Develop upgrading and training action plan for both cadre members and potential members to ensure development and maintenance.	May 2004	July 2004	ZNTB

(*continued*)

Procurement: Short-term Sequenced Actions (*Continued*)

Issue	Recommended Action	Timing: From	Timing: To	Responsible
Streamline the guidelines and operation of the registration system	Streamline the existing registration system.	December 2003	August 2004	ZNTB
	Develop revised guidelines for the operation of the registration system.	August 2004	October 2003	ZNTB
	Implement the improved system and ensure information to stakeholders.	February 2004	September 2004	ZNTB
Establish separate procurement filing systems in PSUs	Develop: – Concept for separate procurement register – Instructions and guidelines to PSUs concerning establishment and maintenance of procurement filing system.	March 2004	September 2004	ZNTB
Develop manuals on (a) procurement planning and (b) contract management	Develop: – Manuals with clear instructions and tools for introducing best practices for (a) procurement planning and (b) contract management – Mandatory training sessions in the subjects for procurement cadre members and contract managers from ministries and agencies.	January 2005	July 2005	ZNTB

Enhance effectiveness and reporting from OAG	Strengthen the mandate and the funding of the OAG office as suggested earlier by the PAC, and Improve timeliness of OAG's yearly report.	Ongoing		AG/Cabinet office
Reduce delays in government payments	"The following should be coordinated with the recommendations coming out of the Financial Accountability Assessment Review: – Change actual release of funds to match the appropriation of funds in the budget and reduce the delays in government payments."	October 2003	January 2004	MOFNP MOFNP
Conduct anti-corruption survey	"The following should be coordinated with the PSCAP project: – Ensure implementation of planned anti-corruption survey."	October 2003		
Involve private sector in procurement reform	Inform the private sector of the action plan. Involve private sector in work groups where suitable.	October 2003	Ongoing	MOFNP/ZNTB/Ministry of Commerce, Trade and Industry

ANNEX E

Procurement: Medium to Long-term Sequenced Actions

Procurement: Medium to Long-term Sequenced Action

Issue	Recommended Action	Timing		Responsible
		From	To	
Set up ZNPA and Develop and establish new independent	Set up ZNPA	February 2005	March 2005	MOFNP
Appeals body authority	Set up the Appeals Body upon enactment of legislation based on UNCITRAL Model Law provisions that mandate a new, independent, part-time appeals body to complement the role of complaints handling given to the new Procurement Authority.	February 2005	July 2005	MOFNP
Implement anti-corruption clauses	Introduce new anti-corruption clauses in the standard bidding documents.	January 2005	July 2005	Procurement Authority/MOFNP
Create training programs and conduct capacity assessment of training institutions	Perform a capacity assessment of training institutions. Agree on a capacity building action plan for each institution with clear targets. Provide funding for upgraded activities and investment in equipment/facilities if needed.	July 2004	November 2004	ZNTB
	Define the training programs needed to supplement the existing CIPS program, for example, mid-career training programs. Visit international training institutions to collect information on other types of training programs.	July 2004	November 2004	ZNTB
	Develop and deliver training programs.	November 2004	Ongoing	ZNTB
Strengthen capacity of clearing agents	Develop a new licensing system for clearing agents.	November 2003	March 2004	ZRA
	Develop a 2–3 day training program for clearing agents. Participation should be mandatory for agents to keep their license.	January 2004	March 2004	ZRA

	Deliver the training.	April 2004	June 2004	ZRA
	Develop guidelines and instructions to clearing agents.	September 2004	December 2004	ZRA
Strengthen capacity of customs officers	Revise current training programs and develop more training on: – Basic customs procedures and use of ASYCUDA system – ASYCUDA's risk analysis module – Physical inspection requirements, corruption prevention, and disappearance of goods – Reduction of under-invoicing – Improvement of duty-drawback system.	September 2003	December 2003	ZRA
	Deliver the training program.	January 2004	December 2004	ZRA
Implement ASYCUDA++	Implement ASYCUDA++ and increase the processing fee to US$5 per declaration.	January 2004	December 2004	ZRA
	Develop training in use of new system.	June 2004	November 2004	ZRA
	Deliver training.	December 2004	Ongoing	ZRA
Develop training in good business practices for the private sector	Develop a training program in cooperation with ZACCI and ZAM on: – Good business practices and ethics – Purchasing, supply, and procurement – Financial management – Effective communication with customers and public authorities.	September 2003	June 2004	Ministry of Commerce, Trade, and Industry
Improve commercial regulations	Examine barriers in commercial regulations and identify measures to improve regulatory practices.	September 2003	September 2004	Ministry of Commerce, Trade, and Industry

ANNEX F

Key Issues in IFMIS Development

Objectives For a New System

The Public Sector Committee of the International Federation of Accountants (IFAC-PSC), the oversight body responsible for establishing International Public Sector Accounting Standards (IPSAS) for Government Operations, has recommended that over time all governments move toward the accrual basis of accounting. The movement toward the accrual basis of accounting has also been supported by the IMF in the recent publication of their Government Finance Statistics (GFS) Manual. Although most governments throughout the world control and report their Government Operations on a cash basis, this can present a misleading picture of financial health since the time of recording expenditures and revenues may differ significantly from the economic activities and transactions to which they relate. Furthermore, it is generally more difficult to assess solvency and future cash flows with the cash basis because information on arrears is missing. Although the implementation of the accrual basis is more difficult than the cash basis, the outcomes of the accrual basis are more reliable and informative.

It will probably take a number of years for governments such as Zambia's that are currently on the cash basis of accounting to fully implement the accrual basis of accounting for the whole-of-government, as recommended by the IMF in the GFS Manual and IFAC-PSC. However, this long-term process needs to begin now. Moreover, the Government should be prepared to incorporate financial statements from Economic Enterprises as part of its whole-of-government reporting, as recommended both by the GFS Manual and IPSAS. In Zambia, where state enterprises have had a history of draining away public resources without substantial public scrutiny, this broader view of financial reporting will be much needed.

Moving From Assessment to Design Phase

IFMIS development projects go through at least four stages as detailed in the box below: (1) assessment, (2) design, (3) procurement, and (4) implementation. Prior missions by the Bank and Fund have generally concentrated on the assessment stage only. During the assessment phase it was recognized that an IFMIS would need to be developed to satisfy the needs of management. The Bank mission recommended that the IFMIS be based on advanced web-based technology and that it be implemented progressively starting with the MFNP and then rolled out to other ministries, cost centers, and local governments. The Ministries would roll out the system to the cost centers within ministries and local governments in co-ordination with the MFNP. The final objective is online processing of all transactions at the source where the transactions are generated.

Phases Of IFMIS Development

- Assessment—Analysis of the current system and identification of areas for improvement; proposal of an alternative system to meet those needs
- Design—Identification of function and user requirements; development of conceptual design; sizing of components in order to prepare the procurement specifications.
- Procurement—Development of procurement strategies, that is, off-the-shelf software purchase versus in-house system development
- Implementation—Pilot testing of system before implementation throughout the operation; extensive training to ensure all aspects of system are performed properly.

Coding Structure

In order to implement the conceptual design there are key issues to be resolved in the adoption of a coding structure and chart of accounts. Central to the development of any accounting system is the adequacy of the coding structure. Although the international oversight bodies do not specify a coding structure, it is implied by the GFS tables. In other words, the coding structure should be robust enough to provide the financial statements identified by the IPSASs and specified in the GFS Manual.[60]

The current coding structure used by MFNP in the accounting system was developed in-house in 1993 and provides for control by budget organization and economic classification only. However, as noted in an earlier chapter, the system will need to be revised to provide cost information by fund, function, and program. To that end in part, an Activity Based Budgeting (ABB) system is in the process of being implemented. In some areas, the ABB coding structure may be more extensive than that needed for the accounting system and in other areas it may be lacking. However, it is important that the budgetary and accounting systems are well integrated and that the needs of each are resolved during the design phase.

60. These include the Statement of Government Operations, the Balance Sheet, the Statement of Sources and Uses of Cash, and the Statement of Other Economic Flows.

In order to provide a good coding structure for the Chart of Accounts, it is recommended that one adopt the codes in the GFS Manual. The existing chart of accounts should be aligned with the GFS Manual in the short-term in order to fully implement a double-entry partial accrual accounting system in the mid-term. Further, a look-up table should be used to convert the existing classifications to the classifications in the GFS Manual in order to maintain historical trend data. In the mid-term, a look-up table could be used for a few years to convert the classifications in the GFS Manual to those used at the present time for historical trend information. In addition, Estimated Revenue and Appropriation accounts should be established in the mid-term in order to record the budget in the double-entry accounting system. Also, Encumbrances and Reserve for Encumbrances accounts should be established in order to implement an encumbrance accounting system. Since the GFS codes are intended for external reporting, the proposed Chart of Accounts may need to be expanded to meet the managerial needs of decision-makers within the government.

The adoption of the GFS codes using the fund structure recommended simplifies the process of reporting Government Operations since data collected during the year will be accumulated in report format rather than converted to some other format at report preparation time. To lessen the impact of transition to the international classification structure, it would be possible to use both (current and proposed) classification schemes during a one or two year transition period. This could be accomplished by running the systems in parallel or through the use of a look-up table. If it is desired to summarize Economic Enterprises by industry (i.e., extractive, conversion, etc.), separate codes could be established to assist in the compilation of this data for the Economic Enterprises.

Network Architecture and Support

To successfully implement IFMIS, the strategy for an information technology infrastructure will need to be developed. This would include servers, software, and storage. Servers are the backbone of the infrastructure and insure that sudden spikes in traffic can be handled as more users performing more complex transactions increase the demands on existing networks. Ultimately, a single network may connect thousands of devices from scores of manufacturers. Much of the work is done behind the scenes, in the network, by bigger computers running powerful and complicated software to provide collaborative solutions that securely bring people and information together. To most efficiently provide for this infrastructure, the architecture should provide for storage devices that will group storage systems on their own high-speed networks.

Initially, MFNP should consider operating a local area network through a web based architecture with central servers and unified databases maintained at the MFNP. Later, the local governments, Ministries and other Cost Centers (who may only need the Purchasing, Human Resources, Budget Management and Financial Reporting modules that are relevant to their operations) can be interfaced with the financial system maintained at MFNP. As these modules are brought online, these modules will be rolled out via the local governments, Ministries and Cost Centers where they are operational in nature. By implementing a web based architecture, the IFMIS will be installed and managed entirely on the servers in a central location that will eliminate the need for desktop software installations and upgrades. This will significantly reduce the costs associated with managing traditional client/server systems and will make the roll out of this solution to local governments, other Ministries and Cost Centers faster and more cost effective.

To implement systems such as IFMIS, the focus of the Computer Center needs to change from its current COBOL/batch systems orientation to real-time, online applications with intranet and internet networking (through a Wide Area Net). This reorientation dictates that a highly secure facility be obtained with access limited to authorized individuals. This facility should have a builtin recovery plan (in case of power outages or other disasters) that will permit the system to degrade gracefully. This would include back-up generators and back-up storage devices.

Capacity building should be guided by a policy that clearly spells out the role of the Computer Center in procuring, supporting, and training user departments on the web based architecture necessary to maintain the information technology. These changes will dictate changes in the organizational structure and the staffing policies.

ANNEX G

Description of a Selected Salary Enhancement Scheme (SASE)

The justification for SASE is premised on the belief that (a) relying on wage-bill savings from employment reductions and government resources are not likely to yield much in the way of pay reform, and (b) whatever results they do yield will be too gradual and too meager to bring about the changes in work behavior required to lead to significant improvements in work performance and service delivery. Thus, extra-budgetary support would lend strength to the GRZ's pay reform effort by accelerating the pace of salary enhancement and jump-starting the overall public sector reform effort. Furthermore, given the reality of limited resources, the enhancements would have to be targeted to posts critical to improving service delivery, managing the reform process, and provision of quality strategic outputs.

Through the SASE scheme the basic salaries of personnel in key positions are enhanced by bringing the medium-term salaries levels forward. For example, if the GRZ adopts such a scheme, beneficiaries would be paid their medium-term target salary levels for 2007/08 upon the scheme's implementation. Then, each fiscal year, as the government makes salary adjustments in line with MTPRS, the gap between actual government pay levels and the target pay levels would narrow, thus, reducing the need for extra financial commitment, as the government's ability to pay competitive compensation out of the general wage bill rises.

With SASE, the long-term sustainability of the salary levels should not be at issue, since the target pay structure will be based upon an affordable wage bill over the MTEF period. As annual salary levels converge towards the target levels, extra budgetary support for salary supplementation will be phased out. Currently, SASE schemes are being implemented in two countries that have reached the HIPC completion point, Bolivia and Tanzania, and under considered for implementation in a third, Mozambique. In each of these countries, the targeted recipients are equal to about 3 percent of the total civil service workforce.

Objective and transparent criteria for the selection of SASE-scheme funded positions is crucial to the success of the scheme. There are various approaches to selecting SASE-scheme positions. They could include for example, targeting all senior managerial, professional, and technical positions; targeting positions based on how critical the position is to service delivery, managing the reform effort, and/or contribution to the strategic outputs of the government; or targeting all incumbents currently receiving special retention allowances.[61] Whatever the basis for selection, however, the supplementation should not be automatic. To ensure that SASE supports public service performance improvement, the positions should have up-to-date job descriptions with clear performance criteria, incumbents should sign performance agreements, and their performance appraised annually.

Implementing SASE-scheme interventions is not without its challenges, as much learning-by-doing is required. However, if structured and implemented properly, it may offer significant benefits to addressing problems of low motivation, lack of competitiveness of the salary structure, and capacity building constraints in the public service. The cost and risk associated with maintaining the status quo (low pay, lack of incentives which undermines performance and efforts to improve service delivery, weaknesses in provision of strategic output) are too high and are inconsistent with the requirements for growth-oriented and modernising economy. The total cost of financing the SASE can be easily estimated since it is merely a function of the number of people covered and the average salary supplement needed to reach the target pay level. Assuming about 2,700 positions were selected (slightly more than the number currently receiving retention allowances), and compensation Scenario 4 were implemented, the annual cost of SASE would be a maximum of 42.3 billion kwacha in the first year (2002/03), declining to zero by year 2007/08. The total financing requirement over the period would be 126.3 billion kwacha (or about US$31.6 million).

61. Retention allowances are paid to certain categories of employees based on their educational qualifications.

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